



Kevane

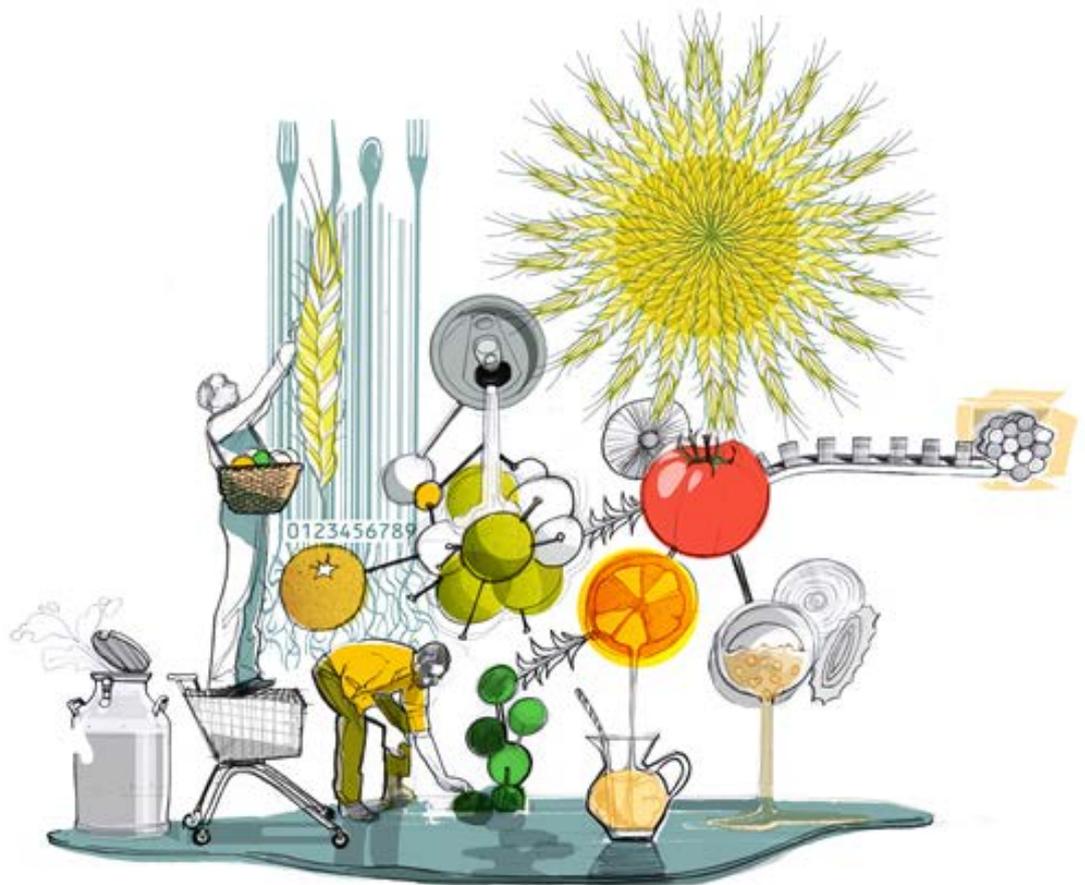
**Grant Thornton**

An instinct for growth™

# Puerto Rico tax and incentives guide

## *Business guide 2016*

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.



## Contents

Foreword .....	3
Kevane Grant Thornton .....	4
About Puerto Rico .....	5
Establishing a business in Puerto Rico .....	7
Puerto Rico tax system.....	18
Tax incentives.....	43
Expatriates.....	61
Contact details.....	66

# 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 US jurisdiction with an array of special tax incentives for foreign direct investment that can be found nowhere else in the world.

Although the economy growth has decreased during the last years, Puerto Rico offers tax incentives packages which can prove attractive to US mainland and other countries companies. These include a fixed corporate income tax rate, one of the lowest in comparison with any US jurisdiction, various tax exemptions and special deductions, training expenses reimbursement and special 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 device, aviation/aerospace, information technology, renewable energy and specialized manufacturing.

We, at Kevane Grant Thornton, have gathered all relevant information to summarize the tax incentives to those interested in doing business in Puerto Rico. At printing time, a tax reform bill is under consideration. If approved as filed, important changes will become in effect. This guide includes legislation in force as of **May 31, 2016**.

It does not cover the subject exhaustively but is intended to answer some of the important, broad questions that may arise. When specific problems occur in practice, it will often be necessary to refer to the Laws and Regulations of Puerto Rico and to obtain appropriate tax, accounting and legal advice.

DISCLAIMER: This contents does not constitute advice. Users should not act solely on the basis of the material contained in this publication. It is intended for information purposes only and should not be regarded as specific advice. In addition, advice from proper consultant should be obtained prior to taking action on any issue dealt with this update.

# Kevane Grant Thornton

Kevane Grant Thornton is the Puerto Rico member firm of Grant Thornton International Ltd offering tangible solutions to its clients through a wide variety of specific services aimed at optimizing their business's yield. The firm has a staff of over 125 professionals who have the right mix of skills and experience to help its clients to achieve success promptly and efficiently. We have over 40 years' experience servicing a diverse group of managers, executives, and business owners.

## How we work

We organize ourselves in a way that enables the senior practitioners to be actively involved in the planning and execution of an engagement and maintain a close professional relationship with each client. We work with our clients to help them achieve their goals with professional services that add true value.

## Our clients

We focus on dynamic organizations, companies with ambition and growth plans, just like us. These dynamic organizations vary from small proprietorships, to middle-market and listed companies.

We have significant experience in providing audit, tax and outsourcing services to a wide variety of business activities, including: advertising agencies, auto dealers, hotels, law firms, restaurants and fast food chains, manufacturers, wholesalers and retailers, shopping centers, construction firms, real estate developers, service companies, non-profit organizations and entities receiving federal aid and grants.

## International Business Centers

Our Firm is an accredited International Business Center (IBC) that provides a gateway to the resources of Grant Thornton globally. IBCs are led by member firm partners around the world with a wealth of experience in international business. They coordinate this expertise to serve clients across borders. There are over 35 IBCs in the Grant Thornton International organization.

## Grant Thornton International Ltd

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

We have been a member firm of Grant Thornton since 1984.

# About Puerto Rico

Puerto Rico, officially 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 US Virgin Islands and the British Virgin Islands.



## Government

The Puerto Rico government has three branches of government: 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 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 US law is involved. The major differences between Puerto Rico and the 50 states are exemptions from some aspects of the Internal Revenue Code, its lack of voting representation, and the ineligibility of Puerto Ricans to vote in 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.

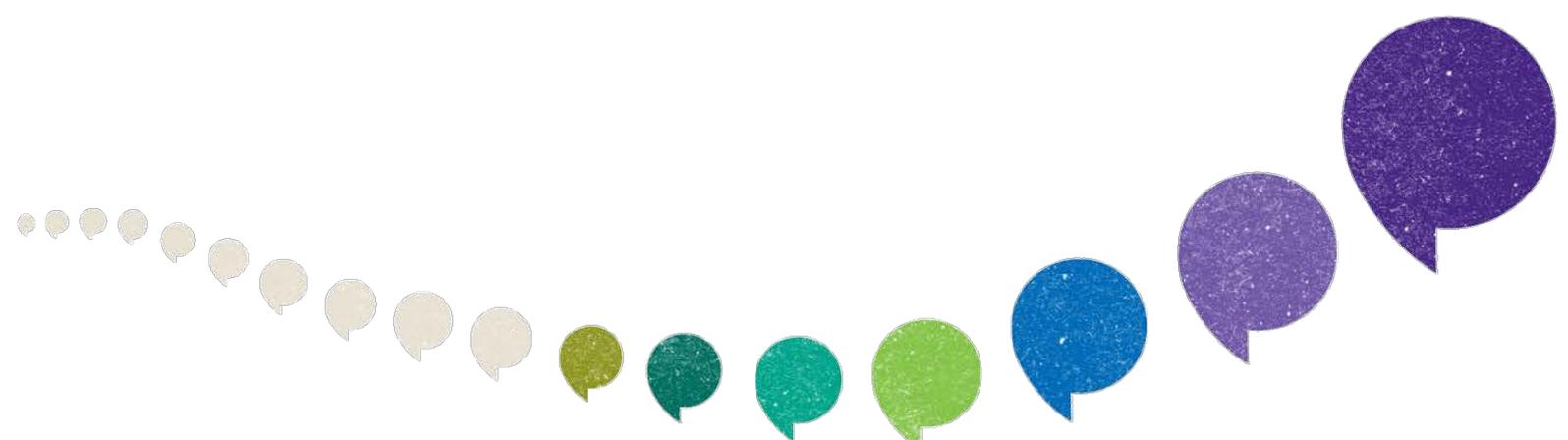
## Population

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 a migration to the US mainland.

The official languages of the executive branch of 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.

**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

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

## Sole proprietorship

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

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

## Partnerships

Under the provisions of the Internal Revenue Code for a New Puerto Rico, approved in January 31, 2011 (the “2011 Code”), partnerships are flow through entities. Rules similar to those applying to partnerships in the US were adopted.

### Civil Code Partnerships

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

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

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

### Commercial Code Partnerships

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

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

Two or more natural persons, including those rendering professional services, can form a limited liability partnership under the provisions of the Limited Liability Partnership Act 7. They must register the limited liability partnership with the Department of State by filing a certified copy of the constituent deed accompanied by a \$100 fee. Registration is valid for one year and must be renewed annually by filing a renewal application and a \$110 revenue voucher. The name of the partnership must include the words "limited liability partnership" (*sociedad de responsabilidad limitada*, in Spanish) or "LLP", "L.L.P.", or "S.R.L."

Generally, a partner in a limited liability partnership is not personally liable for the debts and obligations of the partnership or for negligent or unlawful acts of another partner or employee not supervised by the partner, provided he had no prior knowledge of such acts.

However, the partner may be held personally liable for partnership debts and obligations that arise out of an error, omission, negligence, incompetence, or illegal act committed by that partner or in which that partner was involved, directly or through any person under his or her control or supervision or of which that partner had notice or knowledge.

#### Special partnerships (referred to in Spanish as a *Sociedad Especial*)

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

#### Domestic corporations

Puerto Rico's General Corporation Law 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 corporation's 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 corporate 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 corporate shareholders for the acts of the corporation, except in certain cases, is limited to their investment in its stock.

Any 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 filing fee. De facto corporations are not contemplated under the Puerto Rico General Corporation Law. 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 by-laws, 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 non-U.S. citizens 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 by an officer of the Corporation, 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 licensed in Puerto Rico who cannot be a stockholder or employee of the Corporation. Each annual report must be accompanied by a 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 Puerto Rico laws 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 State Department to process and issue the certificate of registration are \$150. Legal process against the corporation may be served on its authorized resident agent, who must be either a natural or judicial person residing in Puerto Rico, but cannot be a stockholder, officer or director of the corporation.

### Professional corporations

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

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

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

#### 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 may not exceed 75 persons,
- all of the issued stock of all classes must be 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 may not make any public offering that qualifies as such under the United States Federal Securities Act of 1933.

#### Non-profit organizations

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

Instead of shareholders, a nonprofit corporation has members who are not personally liable for the debts of the corporation, except by reason of their own acts. However, members have a fiduciary responsibility toward the non-profit corporation similar to that of a director

in a regular corporation. Also, the members of a non-profit corporation may elect a governing body (typically called a “Board of Directors”) that has the powers and responsibilities of a board of directors of a regular corporation.

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

#### Corporation of individuals (“N Corporation”)

Domestic corporations and partnerships which are owned by 75 or less individuals may elect to be treated as a corporation of individuals for income tax purposes if certain requirements are met. 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 US entity which is solely engaged in a trade or business in Puerto Rico. Like Special Partnerships (discussed above), a corporation of individuals allows the flow through of income and losses to the owners, thus eliminating the double taxation of income.

#### Limited liability company

For income tax purposes, limited liability companies will be taxed in the same manner as corporations. Nevertheless, LLCs may elect to be treated as partnership by filing Form 6045 Partnership or LLC Classification Notification or Election on or before the last day of the third month of the taxable year for which such notification or election will be effective. However, if the LLC is treated as a flow through or disregarded entity for US or other foreign country for income tax purposes, it must be treated as a flow-through for Puerto Rico income tax purposes. This exception does not apply to those LLCs that were operating under a tax grant as of the date of effectiveness of the 2011 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 may dispose of it as directed by the party who transfers the property, named constituent, for his own benefit or for the benefit of a third party, named the beneficiary.” The Civil Code trust provisions do not establish the extent of the liability of a trust, if any, in relation to the debts of its beneficiaries; common law rules would likely be applied to determine such liability.

#### 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 non-profit entity founded by a group of private juridical 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 three and no more than eleven 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 (Act 273-2012)**

The concept of International Financial Entities (“IFE”) was originally introduced in Puerto Rico by Act No. 52 of 1989. International Banking Entities (“IBE”), 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 grant in the nature of a contract between the Government of Puerto Rico and the IBE.

The primary purpose of IFEs is to attract US 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 Puerto Rico Government, 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 authorizes them to engage in traditional banking and financial transactions, principally with non-residents 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, or it can voluntarily convert to an IFE, so that it may broaden its scope of Eligible IFE Activities transactions and obtain a Tax Grant under Act 273.

IFEs are licensed by the Puerto Rico Office of the Commissioner of Financial Institutions and authorized to conduct certain Act 273 specified financial transactions.

#### **Insurance companies**

Insurance Companies include any person engaged in the business of issuing insurance policy contracts, as defined in the Insurance Code of Puerto Rico, as amended. 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 Rican securities, among others.

### Real estate investment trusts

A Real Estate Investment Trust (“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; buildings purchased from the Government of Puerto Rico, its agencies and instrumentalities; and hotels.

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

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

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

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

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

- rents derived from real property located in Puerto Rico,
- interest on obligations secured by mortgages on real property or rights to real property located in Puerto Rico, s

- 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 (“USREIT”) must meet the following requirements to be treated as a REIT under the 2011 Code:

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

#### Registered investment company

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

An 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 US government, the Government of Puerto Rico, political subdivisions, organizations, agencies, or instrumentalities thereof, and cash items,
- invests not more than 25% of the value of its total assets in securities of another issuer, and owns no more than 75% of the outstanding securities of any other issuer,
- does not have fewer than seven 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 twenty-five 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 Corporation

The special employee-owned corporation (“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- 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,

- 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 agro-industrial activities.



# Puerto Rico tax system

## Introduction - US Tax System

### Individuals

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

### Puerto Rico corporations

Puerto Rico corporations are treated as foreign corporations for US income tax purposes. Thus, Puerto Rico corporations are subject to a 30% US 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 US corporation, however, and provided certain conditions are met, are subject to only a 15% US income tax withholding instead of the 30% rate applicable to other foreign corporations.

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

### US corporations

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

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

### Puerto Rico tax system

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

### Individual income taxes

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

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

If the individual's net taxable income exceeds \$500,000, the 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 commenced after December 31st, 2013 is:

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

The ABT on individuals includes most "exempt income" as income for ABT purposes (including income exempted by special statute). Limited exceptions include interest on obligations of the federal government, or Puerto Rico or any instrumentality or political subdivision thereof.

#### Non-resident US citizens

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

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

#### Non-resident aliens

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

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

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

#### Gift tax

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

Both gift and the estate taxes share the same rate: 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.

#### Estate tax

For estate tax purposes, the 2011 Code differentiates between: (1) U.S. citizens who did not acquire their U.S. 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.

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 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 U.S. 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 U.S. Internal Revenue Code (or 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 Puerto Rico estate tax. After filing the estate tax return and paying the corresponding estate 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, the executor is released from that liability one year after the date of the filing of the request.

The 2011 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 Puerto Rico 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 nonprofit 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 Commonwealth 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. As noted on the Gift Tax section, the applicable estate tax rate is 10% of the taxable amount.

The estate tax return is due on or before nine months after the decedent's death.

## Business taxes

### Sole proprietorship

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 2011 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 a husband and wife each own 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 2011 Code, 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 the treatment under the US Internal Revenue 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 on January 1, 2011 may elect to continue being treated as a corporation. In that 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 Corporations

Limited Liability Corporations are generally taxed as corporations, being subject to tax at both the business entity and shareholder levels.

Nevertheless, LLCs may elect to be treated as partnerships for tax purposes, receiving pass-through tax treatment under the partnership rules contained in Chapter 7 of Subtitle A of the 2011 Code, thus being taxed at the partner's level on their respective distributable share of the partnership's income items.

### Special Partnerships ("Sociedad Especial")

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% must be from the performance of one or more of the qualifying activities (i.e. land development, tourism, building and structures lease, sale or rehabilitation of building structures, manufacturing which generates substantial employment, exportation of goods or services, construction or operation of maintenance of public roads and adjoining facilities, agriculture, film production). The special partnership election is not

available for years commencing after December 31, 2010. Those elections made in prior years are still effective.

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

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

#### Corporate income tax

For income tax purposes, corporations (including entities taxed as corporations) and business trusts, among others, are treated the same: there is no flow-through of income or losses to the owners of such business entities, and instead taxes are levied both at the corporate level and again at the shareholder level when actual distributions are made. Before the enactment of the 2011 Code, partnerships were taxed as corporations. Therefore, any reference to corporations in this section also includes 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, then 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 US tax purposes. Therefore, a US corporation operating in Puerto Rico through a domestic subsidiary will not constitute part of the consolidated group for purposes of the filing of US 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:

1. excluding of certain items from gross income;
2. excluding the items of income that are taxed at a different rate;
3. reducing the remaining amount by the corresponding deductions;
4. applying the special tax rates to the special-tax-rate items to determine the tax on special items;
5. adding the partial tax to the tax on special items to determine the total corporate income tax; and
6. 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 twelve (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 2011 Code allows for (a) the 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 cash-receipt-and-disbursement method, the accrual method, hybrid methods, the installment method, the percentage-of-completion method, and the completed-contract method are among the accounting methods allowed for Puerto Rico income tax purposes.

### Inventories

The method of inventory used for tax purposes must conform to the best accounting practice in the corresponding trade or business. The term “best accounting practice,” as used in the 2011 Code, is 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 a conflict occurs, the clear reflection of income should prevail. The most common methods that may be used to identify inventory are: (a) the specific identification method; (b) the first-in, first-out method (FIFO); (c) the last-in, first-out method (LIFO); and (d) the weighted-average cost method.

Pursuant to the 2011 Code, inventories must be valued at the lower of cost or market value. The current regulations (regulations under the 2011 Code 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 2011 Code.

### Gross income

The meaning of gross income is broad and general. The 2011 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 2011 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, Puerto Rico, or political subdivisions thereof;
- 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 2011 Code, corporations may elect to have gains that are derived from the sale or exchange of a capital asset: (i) taxed at a fixed 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 Puerto Rico corporate income 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 (1) 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 a number of 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.

### Non-recognition 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 is treated as derived from sources within Puerto Rico.

##### **Interest Income**

The source of interest income is generally determined by the reference to the residence of the debtor. The 2011 Code grants special 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 grant of industrial or tourist tax exemption 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, intangibles 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 closely follow the applicable rules under the US Internal Revenue Code. Therefore, expenses incurred by a corporation during the taxable year that are directly connected to its business activities are generally deductible.

There are certain items which are statutorily non-deductible even though they would otherwise qualify as a business expense:

#### **Organizational expenses**

Organization expenditures are deductible only when the corporation or partnership is dissolved. When a corporate 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, by-laws, minutes of organizational meetings, and original stock certificates, fees for start-up accounting services, expenses of temporary directors and of organizational meetings of directors or stockholders, 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.

### Travel 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 exceed 25% of the gross income of the person taking the deduction.

### Interest

As a general rule, interests are only deductible if the taxpayer has an obligation to pay the interest and it is ordinary and necessary. However, interest related to an indebtedness incurred to purchase obligations which are exempt from Puerto Rico income taxes is not deductible.

### 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) non-qualified plans. Qualified plans are those specifically covered by the 2011 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 2011 Code. Puerto Rico income tax and all inheritance, estate, inheritance, 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 not deductible (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 2011 Code are:

1. straight-line depreciation,
2. accelerated cost recovery system (ACRS), and
3. flexible depreciation as applicable to those assets for which elected. No new elections are allowed by the 2011 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 may deduct charitable contributions made within the taxable year to religious, charitable, scientific, literary, or educational organizations. The amount of charitable contributions made by a corporation during a year may not exceed 10% of its 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 only allowed to deduct capital losses for up to ninety percent (90%) of the gains from such sale or exchange. Moreover, for taxable years beginning after December 31, 2014, the limitation is further reduced to eighty percent (80%).

The carryover period for capital losses incurred after December 31, 2005, but before January 1, 2013, is ten (10) years. For taxable years commenced after December 31, 2012, the carryover period is seven (7) years.

During the carryover period, the carried-over capital losses are treated as short-term capital losses.

#### Casualty losses

Casualty losses sustained by a corporation 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 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 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 six months, 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 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, are deductible as a business expense.

#### Capital expenditures

The 2011 Code follows the US Internal Revenue 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.

#### Loss 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 (ATM) purposes (explained further on).

#### Non-deductible expenses

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

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

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

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

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

### Tax rates and calculation of taxable income

#### Corporate income tax rates

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

1. a “normal” tax, which is fixed at 20%, and
2. a “surtax”.

#### Normal tax

The first component is calculated by multiplying normal net taxable income times the 20% normal tax rate. The normal taxable net income is regular net taxable income less 85% (or 100%) of the dividend income received from Puerto Rico corporations.

#### Surtax

The net income subject to surtax is normal taxable net income minus \$250,000. 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

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

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

#### Alternative minimum tax

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

The Puerto Rico AMT equals the excess of the amount of the tentative minimum tax over the amount of the normal corporate tax plus surtax. For taxable years commenced after December 31, 2014, the tentative minimum tax will be the greater between:

1. The AMT income at a 30% tax rate; or
2. The sum of the following:
  - expenses or charges from related parties not subject to withholding at the rate of 20%.
  - purchases of personal property to related parties at the following rates:

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

Note that a waiver may be obtained to reduce 60% of the expenses subject to the 20% tax.

#### Assessment and filing

##### Corporate income tax return

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

An automatic three-month extension of time will be granted to corporations for the filing of income tax returns if the extension request is filed on or before the due date of the filing of the income tax return. The extension must be accompanied by the full balance of the income tax due.

Pursuant to the 2011 Code, every corporation whose business volume is equal to or exceeds \$3,000,000 must file audited financial statements for the Puerto Rico operations along with its tax return.

In the case of related entities, as such term is defined in Section 1010.05(a) of the 2011 Code, the business volume will be determined by adding the business volume 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 tax return.

##### Estimated tax

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

### Consolidated returns

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

### Funding the corporation

As a general rule, no income is recognized by a Puerto Rico corporation on the original issuance of its stock. The 2011 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 his 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 non-recognition 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 2011 Code follow a pattern similar to that of the reorganization rules of the US Internal Revenue 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 corporate structure. The recognition of gain or loss is postponed by means of a carryover of the basis.

The 2011 Code lists the same types of reorganizations as the US Internal Revenue Code, except the 2011 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 2011 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 2011 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 of relief against this disallowance but this authority will be limited to 60% of the expenses.

Any actual repatriation of dividends will be subject to a 10% income tax withholding at source and for purposes of filing the US 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 fifteenth day of the sixth 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 non-resident alien individuals or non-resident foreign entities

#### Source of income rule

Certain non-resident alien individuals or non-resident 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 non-resident alien or non-resident foreign corporation or partnership may be treated as the office or fixed place of business of the non-resident 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 non-resident alien individual or non-resident 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 non-resident alien individual or non-resident 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 non-resident alien individual or non-resident foreign entity in Puerto Rico, which for the taxable year or for any of the three preceding taxable years meet one (1) of the following tests:
  - 10% Puerto Rico gross receipt test, or
  - 10% cost test, or
  - 10% commissions and fees test, or facilitation services test.

The portion of the gains, profits, and income of the non-resident alien individual or non-resident 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 the 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 U.S. branch is the same as for a U.S. 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

Informative returns are to be filed for any payment of dividends or any payment in excess of \$500 to individuals for interest, rents, salaries, or wages not otherwise reported premiums, annuities, compensations, remuneration, or other fixed or determinable gains, profits, and income. Any person who credits or makes payments to an individual of \$500 or more and who becomes obligated to withhold the tax on such payments shall file a return specifying the total amount of interest 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.

#### Municipal license tax

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

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

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 9.58% per annum on the appraised value of all taxable personal property in the municipality and up to 11.58% 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, together with the full payment of such tax. If full payment of the personal property tax is received on or before May 15, a 5% discount is allowed.

If the volume of business (defined as gross receipts) of the corporation exceeds \$3,000,000, the property tax return must be accompanied by audited financial statements certified by a Puerto Rico-licensed CPA. 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 Municipal Revenue Collection Center. 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 Treasury Department or other agencies (i.e. alcoholic beverage, cigarettes, financial institutions and air, land and sea carriers, among others).

### Sales and Use Tax

Every merchant engaged in any business that sells taxable items is responsible to collect the Sales and Use Tax ("SUT") as a withholding agent. The SUT rate is 11.5%, and in general will apply to the following items:

1. tangible personal property
2. taxable services
3. admission rights; and
4. bundled transactions.

Every registered merchant, who is a reseller may request a Reseller Certificate and Certificate of Exemption for purposes of the Municipal Sales and Use Tax (For SC 2014 E). This certificate will allow the reseller to take a credit for the SUT paid upon purchases of tangible property for resale up to 100% of the amount to be deposited with the monthly SUT tax return. In addition, it allows its suppliers to collect only 10.5% on those purchases.

The law provides an exemption from the SUT to manufacturing plants on raw material, as well as machinery and equipment to be used in the manufacturing process. In order to claim

this exemption, the merchant has to request the Certificate of Exemption to the Secretary of the Treasury using Form SC 2914 D.

In the case that substantially all sales are made to exempt persons or for exportation, the reseller may request a Certificate of Eligible Reseller (Form SC 2914 F). This certificate will provide exemption to the reseller on the payment of SUT upon eligible purchases.

Special rules apply for the payment of use tax upon introduction to Puerto Rico of taxable property to be used in the business from December 1, 2013, as well as for tangible property to be resold from July 1, 2014.

The law also provides several exclusions and exemptions from the SUT, which depend on the taxable item purchased or the person who purchases the item.

When filing the Monthly SUT Tax returns the merchants will remit the SUT as follows:

- 10.5% to the Puerto Rico Department of Treasury (the Department) and 1% to the municipality where the business is located

#### **Special Sales and Use Tax**

A 4% Special Sales and Use Tax will be applied to services rendered to other businesses and designated professional services.

# Tax incentives

There are several Acts that provide tax and business incentives to qualifying business operations that decide to establish operations in Puerto Rico.

Qualifying industries such as scientific research and development, manufacturing operations, 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 Industrial Development Company (PRIDCO) is the primary government agency tasked with promoting industry and foreign direct investment, and is especially focused on attracting and developing businesses.

## Incentives

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

<b>Puerto Rico's Tax Incentives</b>
• Business, manufacturing and services
• Agriculture
• International Financial Entities (Act 273)
• International Insurer and Reinsurer (Act 98)
• Public Private Partnerships
• Film and Creative Services (Act 27)
• Hotel/Hospitality Development (Acts 118 and 74)
• Jobs Now Act
• Promotion and Development of the Cruiseship Industry
• Education and Training – The Workforce Investment Act
• Foreign Trade Zones
• Small and Medium Business
• Renewable Energy (Acts 82 and 83)
• Export Services Act 20 of 2012 (Act 20)
• Act to Promote the Relocation of Individual Investors (Act 22)
• Young Entrepreneurs (Act 135-2014)
• Private Equity Funds Act (Act 185-2014)

### Business, manufacturing and services

The Economic Incentives for the Development of Puerto Rico Act (Act 73) provides attractive tax and fiscal incentives to foster investment in key sectors of Puerto Rico's economy.

#### Eligible businesses

Businesses established to manufacture products, render services on a commercial scale and/or for foreign markets are eligible businesses in Puerto Rico; as well as businesses established to 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.

#### Application

Act 73 operates through the issuance of a tax exemption decree that lasts for a period of 15 years. The decree identifies and guarantees the incentives to which the eligible businesses are entitled. To obtain a decree, an eligible business must submit an application, with all required supporting documents and fees to the Office of Industrial Tax Exemption.

#### Key provisions

The benefits of Act 73 make industry operations in Puerto Rico highly profitable while stimulating additional economic development. These include:

- 4% - 8% fixed income tax rate,
- 2% or 12% withholding tax on royalty payments,
- 1% income tax rate on "pioneer" activities, which may be further reduced to 0% if the intangible property was created or developed in Puerto Rico,
- minimum combined tax rate of 3% if at least 50% of the exempt business shareholders are residents of Puerto Rico,
- minimum combined tax rate of 3% if a small or medium-size business (average gross income of \$10 million or less during the previous three years); and
- for aerospace activities.

#### Tax credits

Act 73 allows beneficiaries a series tax credits which can be used against their corporate income tax return, such as:

- \$1,000, \$2,500 or \$5,000 jobs creation tax credit, depending on the physical location of the business,
- Research and development credit equal to 50% of the qualified R&D expenses,
- 50% income tax credit for investment in machinery and equipment for the production of energy using renewable resources,
- 25% income tax credit on the purchase of locally manufactured products,
- up to 10% credit to reduce the electric cost of the industrial exempt business; and
- 50% income tax credit for special investment made in Puerto Rico.

#### **Municipal and property tax incentives**

- 90% exemption from personal and real property taxes,
- 60% exemption from municipal license taxes
  - 75% for small and medium-size businesses; and
- 100% exemption from state and local sales and use tax on raw material.

#### **Special Incentives**

Other special incentives have been created to encourage the establishment and retention of local and foreign investment in Puerto Rico.

#### **Job creation incentives**

PRIDCO employs a basic cash grant incentives program to local and non-local business that meet their job creation and retention commitment. The incentive is \$400 per employee for new businesses and \$250 per employee for expansions of existing businesses.

#### **Location incentives**

In addition to the basic incentive above, companies that are promoted by PRIDCO can receive a location-based incentive for job creation outside of the San Juan metropolitan area. This incentive will be available for local and non-local businesses, and it depends on the geographical location of the company and the quantity of persons that will be employed.

#### **Special aid for the rescue of a project**

When a PRIDCO-promoted business intends to cease operations or reduce its workforce by 50% or more, a new owner committed to keeping at least 25% of the employees who are working at the moment of the rescue may be entitled to assistance. The new owner will receive an orientation from PRIDCO and must submit, within six months from the promotion date, certain information for evaluation.

#### **Incentive for strategic projects**

Companies promoted by PRIDCO 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 PRIDCO- may be eligible for incentives.

#### **Incentive for infrastructure development and industrial building improvements**

Companies that are promoted by PRIDCO may be eligible for an incentive to improve buildings that belong to PRIDCO that are necessary for the companies' operations. As a general rule, the infrastructure incentive is not available for improvements to private buildings unless they can help create and retain jobs, in which case the Board of Directors' approval is required.

The company will receive an orientation from PRIDCO and must submit certain information for evaluation by PRIDCO, including project drawings, specifications, cost estimates, agency approvals, and any other document required for the installation or construction of the improvements. The application for this incentive must be prepared and certified by a Licensed Engineer or Architect.

Incentive for the Puerto Rican industry manufacturing of furniture and related products, and the apparel industry and similar products

This incentive is available for Puerto Rican businesses that have been operating for at least one year in the manufacture of furniture or related products or in the manufacture of apparel or similar products that qualify for the economic incentives provided by the Act No. 8 of 1986. Moreover, this incentive can be granted in addition to other special incentives. Businesses that qualify for the incentive will receive a cash incentive of 3% of the eligible sales, up to a maximum amount of \$150,000 per business per year. The incentive can be used to:

- acquire raw materials, machinery or equipment,
- acquire and/or improve the company's manufacturing facilities,
- pay production payroll (where the company is not already participating in another reimbursement program),
- subsidize the lease of buildings housing the manufacturing process,
- acquire technical assistance, training in new production techniques, administration, promotion, and/or marketing,
- improve services through computerized equipment,
- promote the business's services and/or products outside Puerto Rico; and
- make interest payments on loans related to operations, among other purposes permitted under Act No. 8 1986.

To qualify, a company must apply during July or August and submit all required documentation to PRIDCO. The application will be received and evaluated by the Office of Strategic Planning and Economic Analysis.

Once is determined that the company is eligible, it can request the incentive at the end of each quarter.

**Incentive for industries located in Vieques and Culebra**

Companies that are promoted by PRIDCO may be eligible for a cash incentive of up to \$100,000 for establishing and operating a business in Vieques or Culebra. The incentive can be used for maritime, land, and aerial transportation of raw materials and finished products, including labor costs, tolls, and other expenses related to transportation, based on an evaluation by PRIDCO. The eligible company may request the incentive at the end of each quarter, after the commencement of operations has been certified, or at the end of the fiscal year, whichever is more convenient.

The application must include detailed costs. The commitments will be formalized through a contract.

**Marketing Incentives Program**

This matching fund is available to qualified, local, PRIDCO-promoted companies whose sales are greater than \$100,000 per year and whose commencement of operations has been certified. Through this incentive, PRIDCO will reimburse 50% of the cost incurred, up to \$50,000, for publicity, publications, promotional material, market research, and for special promotional activities. The company must submit the application to PRIDCO for evaluation at least 60 days before the promotional campaign or marketing activity will be carried out.

### Special fund for Economic Development

In an effort to attract research and development operations to the island, Act 73 established the Special Fund for Economic Development (“FEDE” for its acronym in Spanish).

The Fund’s monies aim to incentivize the following endeavors:

- scientific and technical research, as well as the development of new products and industrial processes, directly or in collaboration with the Puerto Rico government, universities or a person with knowledge and experience.
- projects under the Industrial Incentives Program in support of PRIDCO’s promotion efforts, including the improvement and development of industrial properties.
- the development and establishment of special self-employment or micro-enterprises programs aimed at integrating economically disadvantaged persons into the mainstream of modern socioeconomic development;
- the establishment of industries of strategic importance to the government, including venture capital funds that promote this type of industry, with the prior authorization of the Economic Development Bank;
- the establishment of programs that promote investment, technology and skill-building for small and medium businesses;
- provide financial support to community businesses;
- the establishment and development of in bioscience, information technology (“IT”), biomedicine and aeronautical engineering;
- entities or programs that further the following initiatives:
  - the establishment of networks of public Internet access, as well as other enterprises directed bridging the digital divide;
  - IT consulting to small and medium businesses; and
  - the establishment of business incubator centers, among many others.
- support regional activities for the purpose of furthering the establishment and development of businesses, research and development, construction, and business incubators, as well as other purposes set forth in Act 73.

Similarly, the Puerto Rico Science, Technology and Research Trust (the Trust)—an autonomous entity that receives funding from the FEDE and the Scientific Research Fund of the University of Puerto Rico among other sources—provides a financing option for research, development, and infrastructure projects in the fields of science and technology. No less than 40% of the Trust’s annual budget is used to finance corporate activities and projects that impact science and technology research and development in Puerto Rico. Between 30% and 40% is invested in academic projects (to match academic research initiatives), recruiting and retaining scientists, and creating an effective structure to commercialize products. Between 20% and 30% is earmarked for the development of research infrastructure, such as institutes, programs, incubators, and more.

## Agriculture

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

### The Agriculture Incentives Law (Act 225)

The Agricultural Incentives Law provides incentives to bona fide farmers and agricultural businesses. To qualify as a bona fide farmer, an applicant must:

1. obtain certification from the Secretary of Agriculture proving the applicant is engaged in an agricultural business, as defined by regulation, and
2. a determination from the Secretary of the Treasury that 50% of the applicant's income derives from this agricultural business.

Farming, animal breeding, agro-industrial operations and other agriculture related operations are eligible for 90% income tax exemption and full exemption from property, excise and municipal taxes under the Agricultural Tax Incentives Act of 1995, as amended. Special tax credits are available for certain investments in eligible agricultural operations.

Bona fide farmers qualify for the following tax benefits:

Tax	% of exemption
Tax on 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 Treasury Department 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 2011 Puerto Rico Internal Revenue Code	90%
Tax credit for investment in eligible	50%

#### Annual bonus for agricultural workers

Law 42 of 1971 establishes that the Secretary of Agriculture will pay an annual bonus to every person who:

1. produces agriculture or livestock,
2. maintains a farm or its direct dependencies, or
3. affects the storage, transportation, distribution and marketing of farm produce.

#### Wage subsidy program to eligible farmers (Law 46 of August 5, 1989)

Law 46 of 1989 subsidizes certain farm wages. Under this law, a farmer initially has to pay farm employees the required wages from his or her own pocket. The government of Puerto Rico, through the Agricultural Development Administration, will then reimburse the farmer the amount of the wage subsidy.

#### International Financial Entities (Act 273)

Act Number 273 of September 25, 2012 (“Act 273”) provides tax incentives to international financial entities that set up operations in Puerto Rico. Act 273 replaces, prospectively, the former International Banking Center Regulatory Act, Act Number 52 of 1989 (“Act 52”), with the objective of improving the conditions for conducting international financial transactions in PR, while simultaneously boosting the Island’s economy.

A licensed IFE can request a grant of tax exemption (“Tax Grant”) from the Puerto Rico Department of Economic Development and Commerce, which will enumerate and secure the following tax benefits provided by Act 273 as contractual rights (i.e., regardless of future changes in Puerto Rico law) for a fifteen (15) year period:

- (1) to the IFE:
  - a fixed 4% Puerto Rico income tax rate on the net income derived by the IFE from its Eligible IFE Activities; and
  - full exemption from property and municipal license taxes exemptions on Eligible IFE Activities.
- (2) to its shareholders:
  - 6% income tax rate on distributions to Puerto Rico resident shareholders of earnings and profits derived from the Eligible IFE Activities; and
  - full Puerto Rico income tax exemption on such distributions to non-Puerto Rico resident shareholders.

As a further incentive, Act 273 can interplay with the previously approved Act 22 of January 17, 2012 (“Act 22”) so that dividends received by an Act 22 bona fide Puerto Rico resident from Eligible EFI Activities would be fully exempt from Puerto Rico income tax, and also from US income taxes to the extent it is Puerto Rico source income pursuant to the source of income rules of the US Internal Revenue Code of 1986, as amended. Therefore, an individual that qualifies as a bona fide resident of Puerto Rico under Act 22, and is a shareholder of a tax-exempt IFE, can benefit from full exemption from Puerto Rico income taxes on distributions of earnings and profits derived from an IFE’s Eligible Activities.

### International Insurer and Reinsurer (Act 98)

Puerto Rico's International Insurer and Reinsurer Act ("IIRA") provides for the creation of international insurers, branches of international insurers, international reinsurers and holding companies. Protected cell plans and securitization plans are allowed.

To qualify as an international insurer or reinsurer under the IIRA, an insurance company must be approved 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. An International Insurer Holding Company is a Puerto Rico legal entity that holds shares or other securities of an International Insurer or another International Insurer Holding Company. A branch is a business unit through which a foreign insurer not organized under Puerto Rico law carries out business transactions along the lines of an International Insurer.

International Insurers, Branches, and International Insurer Holding Companies are given attractive tax treatment:

Tax	Tax Rate
Income Tax	0%
Branch Profit Tax	0%
Dividends / Other Distributions of Profits	0%
Distributions in Liquidation	0%
Municipal License Tax	0%
Property Tax	0%

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

The recently enacted Act No. 98 of 2011 facilitates the establishment of entities that export insurance and reinsurance services, allowing Puerto Rico to compete with jurisdictions such as Bermuda, Cayman Islands or the State of Vermont.

### 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 on their way. Please contact us should you be interested in obtaining more information.

### Film industry and creative services

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

### Puerto Rico Film Industry Incentives Act (Act 27)

The Act brings 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 Act also provides for numerous incentives for the development and operation of related infrastructure, specifically high-capacity production studios.

#### Production incentives

- 40% tax credit on all payments to Puerto Rico residents,
- 20% tax credit on all payments to non-resident talent (including stunt doubles). Payments made to non-resident talent are subject to a 20% withholding over the Puerto Rico income;
- 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.
- \$50,000 minimum spending requirement per project (\$25,000 for short films);
- there are no principal photography requirements per project, therefore full or partial development, pre-production and post-production may qualify. If 50% or more of principal photography is shot in the island, development payments to Puerto Rico residents may qualify;
- no per project or individual wage caps;
- no cap on credits for payments to qualified non-resident. The annual cap on credits for payments to Puerto Rico residents is \$50 million.

#### Infrastructure incentives

- 25% tax credit on costs for development or expansion of infrastructure projects.
- minimum hard costs of \$5 million.
- maximum aggregate annual cap of \$10 million and lifetime cap of \$150 million for all infrastructure credits. Such credits shall only be available when a project is completed and ready for use and may be carried forward only if the corresponding project is in operation pursuant to the terms of its Grant.

#### Film development zone

People engaged in qualifying media and infrastructure projects, as well as the operation of a large-scale studio within the film-development zone, will benefit from the following incentives:

- 4% fixed income tax rate
- 100% exemption on dividends

- 90% exemption from municipal and state taxes on real and personal property
- 100% exemption from municipal license, excise and other municipal taxes.

### Hotel/Hospitality Services

The Puerto Rico tax incentive package offers hotel developers a competitive advantage over developing in other destinations. Act No. 74 of 2010, known as the Puerto Rico Tourism Development Act, aims to facilitate the establishment of tourism-development projects throughout Puerto Rico. Act 118 of 2010, known as the Law for Municipal Economic and Tourism Development, seeks to facilitate the establishment of world-class tourism development projects throughout Puerto Rico.

### Tourism Incentives for the Economic Development of Municipalities of 2010 (Act 118)

The main criteria for eligibility:

- being a world-class hotel with a 4-star rating,
- planning for a diverse commercial and recreational establishment,
- other tourist attractions and facilities typical of 4-star hotels, including casinos,
- the project must be developed exclusively with private capital.

Tax incentives on net income from casinos will be granted according to the following scale:

Investment	Fixed Tax Rate
\$500 million	25%
\$750 million	15%
\$1.0 billion	10%
\$1.25 billion	8%

### Tourism Development Act of Puerto Rico of 2010 (Act 74)

Act 74 bestows a series of tax credits and incentives to both new and existing tourism business that are deemed eligible under the Act.

An *existing business* is one that, at the time of requesting preferential tax treatment under Act 74 (i.e. the “filing date”), 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 (3) years prior to said filing date,
- have not been used for tourism activities during the previous eighteen (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 will be subject to an expansion and/or renovation which will exceed one hundred percent (100%) of its acquisition cost or Fair Market Value at

conveyance, and said investment is completed within thirty-six (36) months after said acquisition or conveyance.

The following business activities qualify as tourism-related activities:

- ownership or administration of (1) hotels, condo-hotels, timeshares/vacation clubs, hostels, guesthouses, excluding the operations of casinos, (2) theme parks, golf courses, marinas for tourism purposes, port facilities in areas that promote tourism activities, (3) natural resources as a source of entertainment value, and (4) other entertainment or recreational tourism-related facilities.
- leasing or rental of property to an exempt business dedicated to tourism-related activities.

#### Tax Exemptions

Tax	Percentage of exemption
Income taxes	Up to 90%
Property taxes	Up to 90%
Municipal license taxes	100% for New Business
Sales and use tax	Up to 100%
Municipal construction tax	Up to 100%

The tax exemption period lasts for ten (10) years and may be extended for an additional 10-year term.

#### Tax Credits

Any person who acquires an equity interest in a corporation or partnership that develops an exempt tourism business, or who invests in a Condohotel, will be entitled to an investment tax credit equal to 50% of the cash paid for such equity investment. Land contributed to the corporation or partnership in exchange for an equity interest will also qualify for the investment tax credit.

The 50% credit is to be taken in two installments: half of the credit during the first year of the investment, while the remaining credit may be used in the second year. Any unused tax credits may be carried forward.

The total amount of the investment tax credit which may be taken by all investors cannot exceed 10% of the total cost of the tourist project. If the 10% limitation is exceeded, the equity investors who are the developers of the project (as opposed to passive investors in the project) will be liable for excess investment tax credits taken by them.

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 projects capital structure.

### Promotion and development of the cruise line industry

The cruise industry is 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.

Act No. 113 of 2011, known as the Act for the Promotion and Development of the Cruise Ship Industry, further strengthens 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 non-residents 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. This Act simplifies the industry's dealings with the government making the process of obtaining incentives more efficient, transparent and simple.

### Incentives for local certified suppliers

The Puerto Rico Tourism Company ("PRTC") reimburses cruise ship owners ten percent (10%) of food and beverage purchases made from Certified Local Suppliers while the cruise ship is docked at any Puerto Rico port. The cruise ship owner must submit copies of all invoices for purchases from any Certified Local Supplier and a detailed log of its purchase receipts for the end of each calendar month. The PRTC will also reimburse the cruise owner an additional five percent (5%) for purchases of products from or manufactured in Puerto Rico (as certified by the PRIDCO and the Puerto Rico Department of Agriculture) made while docked at any Puerto Rico port.

### Education and Training- the Workforce Investment Act

The Puerto Rico Human Resources and Occupational Development Council (HRODC) administers funds received by Puerto Rico under the federal Workforce Investment Act (WIA). The program offers workforce training incentives to businesses through on-the-job-training, customized training, combined programs, and retraining:

- on-the-job training: WIA reimburses up to 50% of the salary of the participant for the duration of the training, which will vary according to the occupation and the participant's professional and educational experience level.
- customized training: WIA reimburses up to 50% of the salary of the participant as compensation for extraordinary costs and additional supervision that comes with the training.
- combined program: WIA grants 100% of training costs and up to 50% of the participant's salary for the duration of the training.
- retraining: WIA grants 100% of the costs of retraining employees to handle new tasks and up to 50% of the salary of the participant during the retraining period.

### Foreign Trade Zones

Puerto Rico has the largest non-contiguous Foreign Trade Zone (FTZ) 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 US 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
- 100% exemption on exports from the zone and sub-zones.

### Small and medium business

Small- and medium-sized enterprises (SMEs) play a significant role in the economy of Puerto Rico, and the government is focused on facilitating their growth. Two governmental agencies are particularly focused on SMEs: the Economic Development Bank and the Puerto Rico Trade and Export Company.

### The Economic Development Bank

The Economic Development Bank (EDB) offers financial support to SMEs through: asset-based loans; participation loans with private financial institutions or under the SBA 504 loan guarantee program; mezzanine financing or capitalization loans; tourism project loans; management buy-out loans; and credit lines for operational capital.

The EDB financial support includes loans of:

- up to \$500,000 for women entrepreneurs,
- up to \$5 million for agricultural projects,
- up to \$500,00 for new-business owners,
- up to \$300,000 for environmentally friendly projects,
- up to \$5 million for businesses that help their industry.

The EDB provides lines of credit of:

- up to \$750,000 for federal contractors,
- up to \$750,000 for companies looking to export.

### The Puerto Rico Trade and Export Company

The Puerto Rico Trade and Export Company (*Compañía de Comercio y Exportación* or CCE in Spanish) is a public corporation under the Department of Economic Development and Commerce's umbrella. CCE's mission is to foster the development of trade with special emphasis on small and medium sized businesses, and the export of Puerto Rican products and services to other countries or regions. Among the services it provides are the following:

#### Financing and Consulting Services

CCE offers consulting services on matters such as how to establish a new business or how to expand an existing business, available options for financial help in state and federal agencies, and commercial projections and financial statements, among others.

#### Foreign Trade and Business Development Institute

ICEDE, for its acronym in Spanish, designs functional training courses to instruct SMEs on the latest business trends. ICEDE is accredited by the Association for Continuing Education

and Training and offers over 50 kinds of training geared towards improving businesspersons' capacity and knowledge on topics such as human resource management, international trade, labor laws, computer programs, and others.

#### **Voluntary Chain Program**

The Voluntary Chain Program allows groups of independent businesses to unite under one name to create a common market and strengthen their competitiveness. Voluntary Chains must be endorsed by the CCE. Once endorsed, these entities are exempt from municipal license taxes for the volume of their generated sales and inventory tax payments. They tend to benefit from reduced operational expenditures, more bargaining power to obtain better terms and prices on group purchases, and stronger brands. Each owner can have up to five establishments within the chain.

#### **Commercial Facilities**

CCE's real estate division can provide storage facilities for product distribution. CCE manages strategically located warehouses and commercial facilities in San Juan, Ponce, and Mayagüez. From these warehouses, clients distribute consumer goods such as food, pharmaceuticals, chemical products, and others to local and international markets. CCE also maintains the facilities known as the *Centro Mercantil Internacional*, the Distribution Center, and the Foreign Trade Zone 61 in Guaynabo.

#### **Puerto Rico Exports**

This program seeks to stimulate and promote Puerto Rican exporting activity by providing analyses of a business's exporting potential, support in identifying potential international markets, technical assistance in the exporting process, workshops and seminars on international trade, and participation in international business fairs and missions, among other benefits.

#### **Free Trade Zone 61**

Businesses can reduce their storage and operational costs when they establish operations in Foreign Trade Zone 61 or create a sub-zone within their place of operation. This can eliminate or postpone merchandise taxes and duties.

#### **Puerto Rico World Trade Center**

The PRWTC provides access to the best ideas in international business, provides access to new international marketing channels, and extends the benefits of the World Trade Center Association to its members. PRWTC offers a wide range of services for businesses interested in internationalizing their products and services: business training, meeting rooms, local and international business missions and fairs, international business services and counseling, and the international business library.

#### **Credit for Electric Power**

The Puerto Rico Electric Power Authority (PREPA) is authorized to grant a 10% credit, up to a maximum of \$40 per month or \$80 per year, to small retailers or non-professional personal logistics facilities with seven or fewer employees that are located in urban centers.

### Renewable energy (Acts 82 and 83)

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.

**Act 82 of 2010**, also known as the Energy Diversification by Means of Sustainable and Alternative Renewable Energy Act was approved on July 19, 2010, along with **Act 83** of 2010, also known as the Green Energy Incentives Act.

### The Energy Diversification Act

The Energy Diversification Act established a series of the guidelines to promote the generation of renewable energy in Puerto Rico and the creation of a Renewable Energy Commission (the "Commission"). The Commission will work closely with the Puerto Rico Energy Affairs Administration ("PREAA") to ensure compliance with the Renewable Portfolio Standard described below.

### Renewable portfolio standard

The Energy Diversification Act provides for the establishment of a Renewable Portfolio Standard ("RPS") in Puerto Rico, which requires the increased production of energy from renewable energy sources. Renewable energy sources under the Energy Diversification Act include, but are not limited to, solar, wind, gas to energy and waste to energy.

### Renewable energy certificates

The adopted legislation establishes Renewable Energy Certificates ("RECs") as the main financial mechanisms to achieve these goals and validates them as legally-recognized assets that can be purchased, sold, traded, and transferred separately from the energy generation. A REC represents the equivalent to 1MWh of electricity generated by a renewable energy source which can then be sold, traded or transferred by the generator of the renewable energy. PREPA would be allowed to purchase, and thereby use, the RECs to comply with the production target requirements established by the RPS. The Energy Diversification Act proposes that the RECs will trade in the open market. The Government of Puerto Rico is committed to ensuring that the RECs can be banked and traded for purposes of financing renewable energy projects in Puerto Rico.

### Green Energy Incentives (Act 83)

Act 83 provides for the creation of a Green Energy Fund ("GEF"), as a special, independently administrated fund to bankroll certain economic. Through the GEF, the Government of Puerto Rico will co-invest \$290 million in renewable energy projects over the next 10 years.

The PREAA, together with an evaluation committee, will be responsible for the management of the funds in the GEF. The GEF will evaluate renewable energy projects based on the following tiered system:

- Tier 1 - Small projects that can generate up to 100kW
- Tier 2 - Medium projects that can generate between 100kW and 1MW
- Tier 3 - Large projects with the capacity to generate over 1MW.

Act 83 grants tax incentives to companies dedicated to the production of renewable energy on a commercial scale in the form of:

- 90% exemption from real and personal property taxes,
- 60% exemption from municipal license taxes,
- 100% exemption from sales and use taxes and excise on certain items used in connection with the green energy project,
- 60% exemption from any municipal taxes levied pursuant to a municipal ordinance,
- 100% 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,
- fixed income tax rate of 4% in lieu of any other income taxes imposed by the Internal Revenue Code for a New Puerto Rico; and
- 100% exemption from income taxes for dividends paid from income derived for renewable energy activities.

Moreover, Act 83 allows the Government of PUERTO RICO flexibility to establish new investment or incentive programs in the future.

#### Export Services Act of 2012 (Act 20)

The Export Services Act endeavors 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.

Through the execution of a Tax Exemption Grant, the Act offers a number of incentives to business engaged in eligible services in Puerto Rico for an initial term of twenty (20) years. The benefits can be further extended for an additional ten (10) years, granted the eligible business complies with the established employment, income and investment requirements, as well as any other factors mentioned in the grant that prove the DDEC Secretary that its extension will benefit the economic and social interests of Puerto Rico.

The term *eligible service* comprises, but is not limited to:

- research and development,
- advertising and public relations,
- economic, environmental, technologies, scientific, managerial, marketing, human resources, information systems, engineering, auditing, and other consulting services,
- advising and consulting on matters related to any industry or business,
- advanced professional services such as legal, tax and auditing services,
- production of engineering and architectural blueprints and designs,
- 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;
- international trading Companies; and
- many other services included within the Act, as well any other service designated by the Secretary of the Department of Economic Development and Commerce of Puerto Rico.

Tax rate and incentive period:

- 4% income tax rate, which can be reduced to 3% if:
  - more than 90% of the eligible business' gross income and its affiliates is derived from exporting services; and
  - the service is considered a “strategic service”, as defined within the Act.
- 0% income tax rate on dividends or profit distributions,
- 100% exemption from real and property taxes on call centers, corporate headquarters and distribution centers, for the first five years of operations. Afterwards, the exemption is reduced to 90% for the remainder of the Tax Exemption Grant's.

For the concession of these benefits, the Department of Economic Development and Commerce imposes an employment requirement of five (5) employees which must be met within the first two (2) years from the commencement of operations and continued throughout the remaining exempted period.

[Act to Promote the Relocation of Individual Investors \(Act 22\)](#)

This law 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 such individuals become bona fide residents of Puerto Rico.

The Individual Investors Act applies to any individual investor that becomes a Puerto Rico resident on or before the taxable year ending on December 31, 2035, provided that such individual was not a resident of Puerto Rico at any time during the 6-year period preceding the effective date of the Individual Investors Act.

Provisions

- 100% tax exemption from Puerto Rico income taxes on interest and dividend income derived during the Tax Exemption Period to Resident Individual Investors. “Section 933 Exclusion”, interests and dividends received by Resident Individual Investors that qualify as Puerto Rico source income will not be subject to federal income taxation under the US Code.
- 100% exempted from Puerto Rico income taxes for long-term capital gains (“LTCG”) derived by Resident Investors for investment appreciation accruing after becoming a Puerto Rico resident, if such gain is recognized prior to January 1, 2036.
- on the other hand, LTCG derived by Resident Individual Investors will be subject to preferential income tax rates in certain circumstances.

The tax exemption granted under the Individuals Investors Act will expire on December 31, 2035 (the “Tax Exemption Period”). As requisite for the granting of these benefits, the applicant must provide evidence of a personal or commercial bank account in a financial institution or credit union with presence in Puerto Rico. In case the applicant has not moved to Puerto Rico, he/she may submit the evidence as soon as he/she resides in Puerto Rico.

Also, the applicant must acquire residential property for the issuance of an Act 22 grant within two (2) years from date of notification of Puerto Rico residency, thorough evidence of the execution of a Deed of Purchase and Sale

### Young Entrepreneurs Incentives Act (Act 135-2014)

The Act aims to both 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 Act, the first \$40,000 of earned income is exempt from income taxes.

Also, the Department of Economic Development and Commerce will establish a student loan refinancing plan at competitive rates not to exceed six percent (6%) in exchange for the applicant committing to live and work in Puerto Rico for at least six (6) years or for the negotiated repayment term, whichever is longer.

The Act also establishes a series of benefits with the Puerto Rico Trade and Export Company. Through the execution of an Agreement, the applicant commits to develop a business and create employment opportunities, in exchange for a 3-year total exemption from income, property and municipal license taxes on the first \$500,000 of gross income. The excess of \$500,000 will be taxed at ordinary tax rates.

### Private Equity Funds Act (Act 185-2014)

The Act seeks to provide Puerto Rico companies that have no access to public capital markets, the opportunity to be financed by a group of investors in order to contribute to the economic development in Puerto Rico.

Any partnership or limited liability company organized under the laws of the Commonwealth 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 can qualify as a Puerto Rico Private Equity Fund or a Private Equity Fund.

If the Fund complies with the Act’s various requirements, it will benefit from a total exemption on interest, dividends and capital gains, as well as from municipal license taxes and real and personal property taxes.

In the case of the Fund’s accredited investors, they will be subject to a fixed 10% on interest and dividend income, while Puerto Rico-sourced capital gains will be exempt. Also, the sale of ownership interest will be subject to a fixed tax rate of 5%, unless the proceeds are reinvested within 90 days in a Puerto Rico Private Equity Fund. 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 both General Partners and Registered Investment Advisors, interest and dividend income will be subject to a fixed tax rate of 5%, and capital gains to a 2.5%.

# Expatriates

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

## Facts

### Employment visas

Foreign nationals who wish to work in Puerto Rico on a temporary basis (that is, they will not obtain permanent residence) must be certified by the US 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 Rican employer. Again, US immigration rules are fully applied in Puerto Rico.

Where the expatriate is a US citizen the above procedure is not required.

### Tax returns and compliance

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

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

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

### Tax year

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

### Tax Rates

Ordinary tax rates vary from 0% to 33% as prescribed by the Puerto Rico Internal Revenue Code of 2011.

There is a gradual adjustment of the lower tax rates, the personal exemption and credit for dependents for taxpayers whose net taxable income is over \$500,000 for 2015. The law also provides for an Alternate Basic Tax.

Income tax rates for 2015:

Marital status	Taxable income (US\$)	Tax payable (US\$)
Individual taxpayers, married, not living with spouse and married couples filing joint return, estates and trusts	0 - \$9,000	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

Sample of income tax calculation for year ending December 31, 2015:

2015		US\$
Employment income		74,500
Benefits provided	Home	3,450
(taxable)	Host	24,750
	Total benefits	28,200
Gross income		102,700
<b>Less</b>		
Qualified pension contributions (employees)		(10,000)
Overseas workdays (20% of gross income)		(20,540)
Personal allowance		(7,000)
<b>Taxable income</b>		<b>65,160</b>
	<b>Tax bill</b>	<b>9,900</b>

### Basis of taxation

#### Charge to tax

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

#### Residence

As mentioned above, the income that will be subject to Puerto Rico's income tax will be determined by the expatriate's residence status.

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

For US purposes, Section 937 of U.S. Internal Revenue Code has established rules to determine whether an expatriate is considered a bona fide resident of Puerto Rico. Namely, the following two (2) criteria must be met:

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

Determination of residency is important, because a Puerto Rico resident will be taxed in Puerto Rico on his/her worldwide income. A non-resident, however, will be taxed in Puerto Rico only on his/her Puerto Rico source income, which in the 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 non-resident, a tax will be assessed on employment income derived from services rendered in Puerto Rico. Some exceptions apply, depending on the amount of income generated in Puerto Rico and the time spent in Puerto Rico. If the expatriate is considered a Puerto Rico resident, then all individual's income, no matter where earned or derived, will be taxed in Puerto Rico.

Assessable employment income includes all wages, salaries, overtime pay, bonuses, gratuities, perquisites, benefits, etc., that constitutes compensation for services.

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

#### Source of employment

As mentioned above, when services are rendered in Puerto Rico, the income is sourced to Puerto Rico and, thus, subject to Puerto Rico taxation for both residents and non-residents. In addition, in the case of resident expatriates, all other worldwide income will also be subject to Puerto Rico taxation.

#### 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 US) on income also being taxed in Puerto Rico.

### Deductions against income

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

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

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

### What taxes?

#### Capital gains tax

Long term capital gains are subject to a maximum rate of 15% as of 2015. Short term gains (one year or less) are subject to the regular income tax rates. Again, an expatriate's exposure to income tax on capital gains will be determined by their Puerto Rican tax residence status. Under the new provisions of the 2011 Code, capital gain source of income on the sale of personal property in general, depends on the residence status of the taxpayer. In general, capital gains tax will be assessed on net gains after deducting the cost of acquisition of the asset from sale proceeds.

#### Inheritance, estate & gift taxes

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

#### Investment income

The expatriate's tax residence status determines whether investment income such as interest, dividends, etc., is subject to Puerto Rican income tax.

#### Local taxes

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

#### Real estate tax

Real estate tax rates fluctuate depending on the municipality the property is located in. Rates vary from 7.80% to 10.33%. Expatriates are affected only if they own real property, i.e. a house, in Puerto Rico.

#### Social security taxes

United States social security contributions apply in Puerto Rico on the same basis and rates as in the US. Please refer to these rules to determine how they may affect your assignments to Puerto Rico.

### Stock options

Stock options may be qualified or non-qualified. 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 six months 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 parts of the expatriate's duties are performed outside of Puerto Rico, any employment income received in respect of the foreign duties will remain not subject to Puerto Rican tax, provided the expatriate is not a resident of Puerto Rico.



# Contact details

Puerto Rico International Business Centre (IBC)  
33 Bolivia Street Suite 400  
San Juan, Puerto Rico 00917  
T +1 787 754 1915  
F +1 787 250 1046  
W [www.kevane.com](http://www.kevane.com)



**María de los Angeles Rivera**  
Partner Head of Tax | IBC Director  
E [maria.rivera@pr.gt.com](mailto:maria.rivera@pr.gt.com)



**Lina Morales**  
Tax Partner  
E [lina.morales@pr.gt.com](mailto:lina.morales@pr.gt.com)



**Francisco Luis**  
Tax Partner  
E [francisco.luis@pr.gt.com](mailto:francisco.luis@pr.gt.com)



**Isabel Hernández**  
Tax Partner  
E [isabel.hernandez@pr.gt.com](mailto:isabel.hernandez@pr.gt.com)



© 2016 Kevane Grant Thornton. All rights reserved.

"Grant Thornton" refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires.

Kevane Grant Thornton is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms.

GTIL and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions.

Please visit [www.kevane.com](http://www.kevane.com) for further details.