

Doing business in Puerto Rico

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

Business guide 2021



Audit



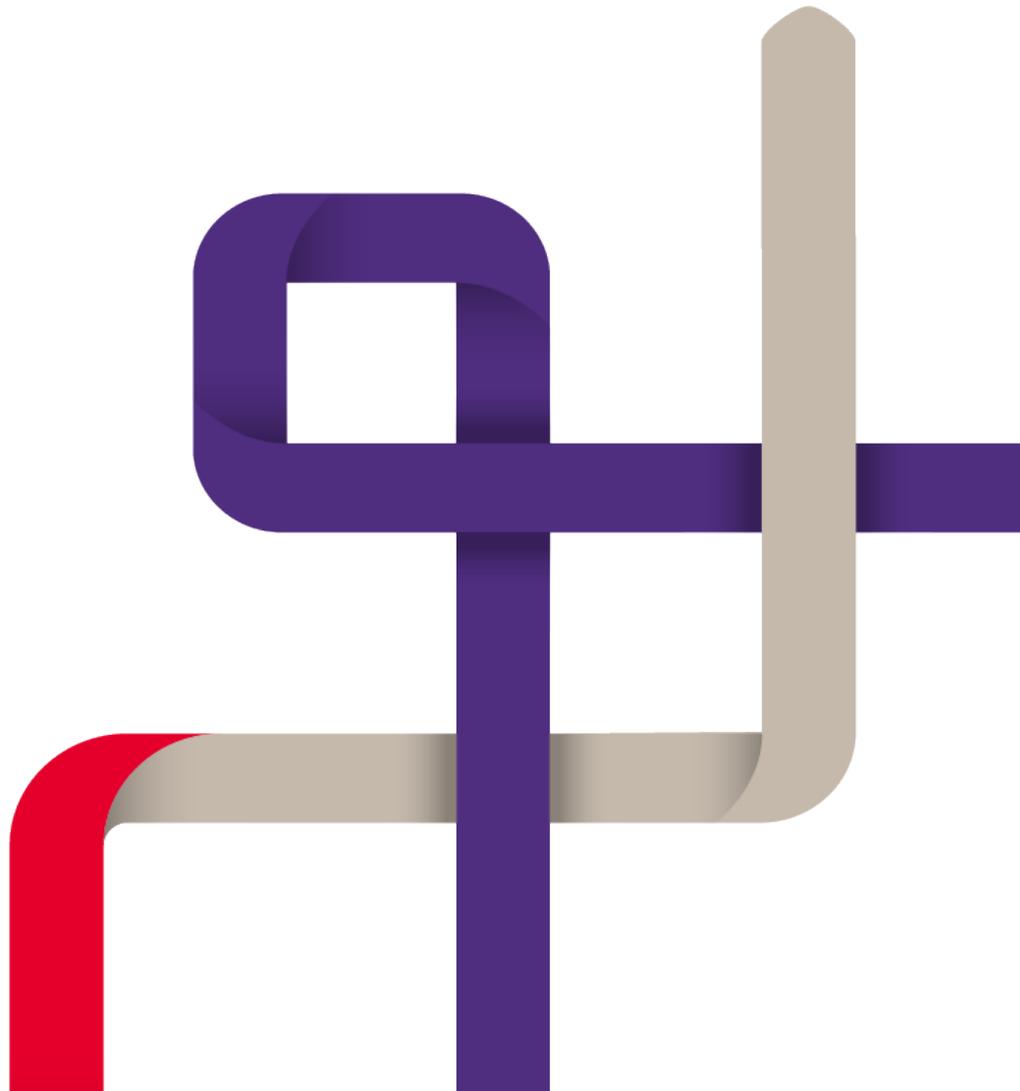
Tax



Advisory



Outsourcing



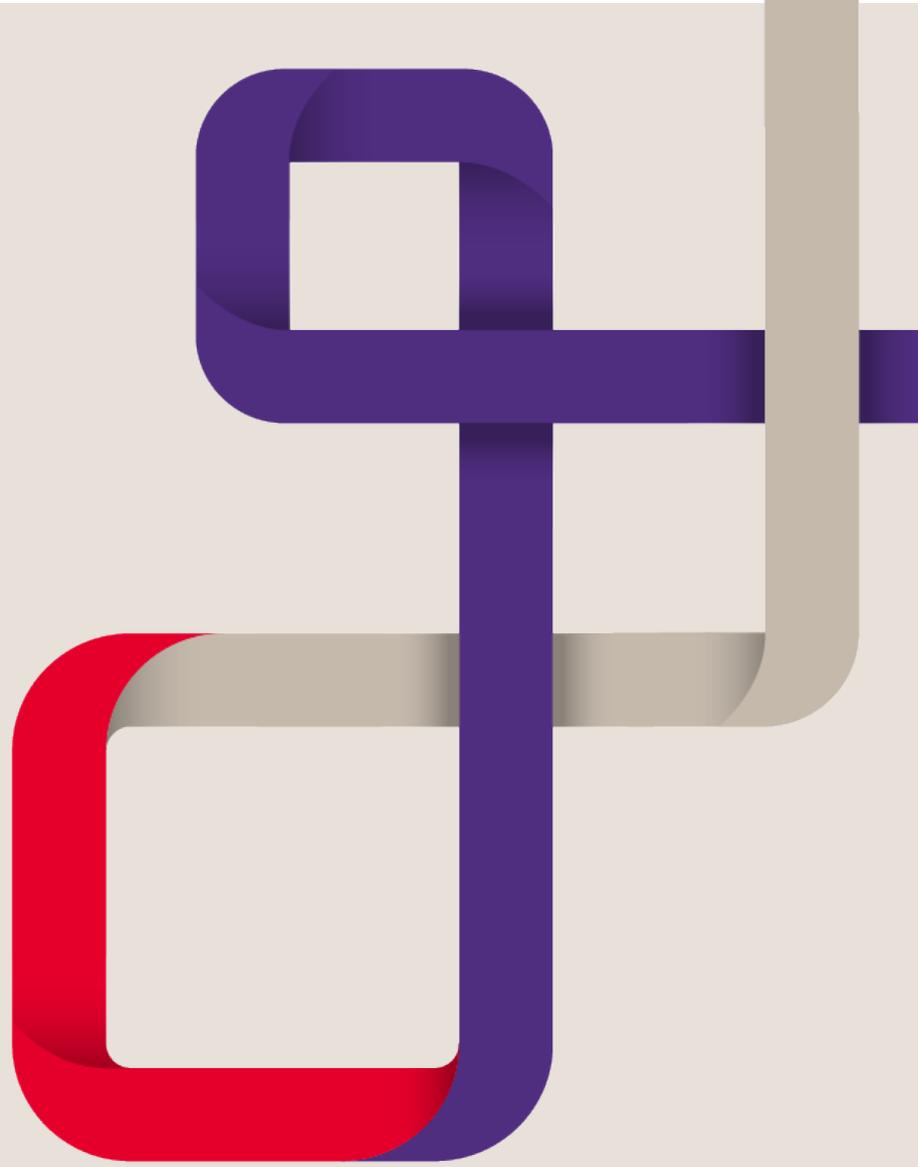
“We want to exceed your expectations. Our partners work closely in the planning and execution of an engagement, which allows us to help our clients achieve their personal and business goals.”

Luis Carlos Marciano
Managing Partner



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Foreword

Foreword

Puerto Rico, a territory of the United States of America (“U.S.”), provides the perfect environment to invest. In addition to a strong legal framework, highly skilled bilingual workforce, and infrastructure, Puerto Rico offers tax incentives packages which can prove to be attractive to individuals and businesses from the U.S. and other foreign countries, making the island an extraordinary destination to conduct business. Nevertheless, it is essential that prospective investors obtain proper and sound advice concerning regulatory and legal matters arising from the conduct of business in Puerto Rico.

Kevane Grant Thornton has prepared this guide to assist those interested in doing business in Puerto Rico. It does not cover the subject exhaustively but is intended to answer some of the most important, high-level questions that may arise.

When specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico and obtain appropriate tax, accounting, and legal advice.

This guide contains laws as of **December 31, 2020**.

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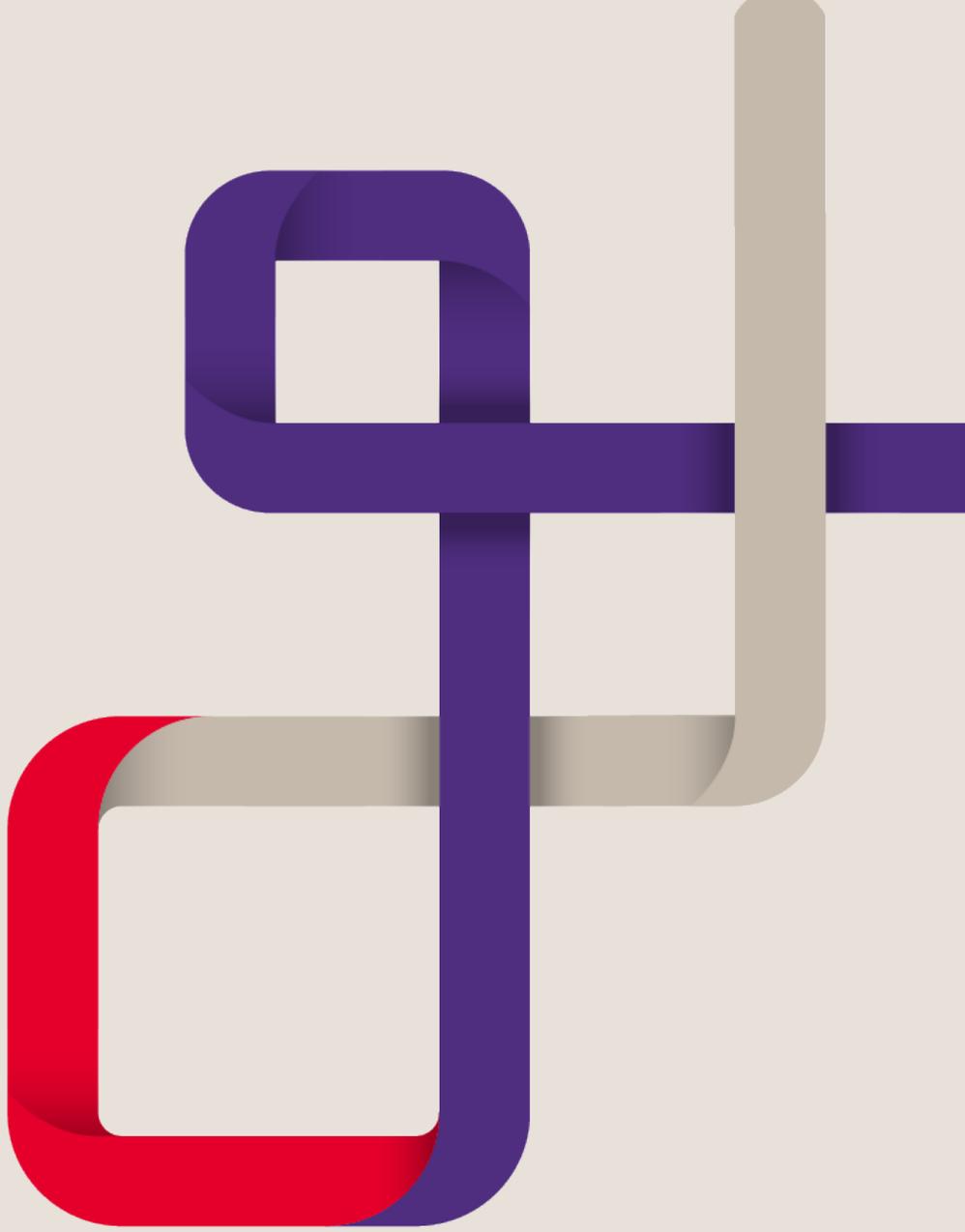


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countries

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Country profile

Country profile

Summary

Basic data

Population (fiscal year 2018-2019, except where noted)

3.2 million

Area	9,104 sq. km (3,425 sq. mi)
GDP (purchasing power parity)	USD 101.131 billion (estimate)
GDP – per capita (PPP)	USD 31.603 (estimate)
Exports	USD 69.987 billion
Imports	USD 54.761 billion
Literacy rate	92.4% (2017)
Life expectancy	81.3 years (2020 estimate)
Urban population	93.6% (2020 estimate)
Local currency	U.S. Dollar (\$)

Geography and population

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

Puerto Rico is the most eastern of the Greater Antilles between the Caribbean and North Atlantic Ocean, about 1,050 miles southeast of Miami. By air, it is just over 3 hours from New York.

According to the 2020 U.S Census of Puerto Rico, the revised population estimate is approximately 3.2 million people, and is the third-most populated U.S. State, Territory, or Possession.

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

Government

A self-governing Commonwealth within the U.S. constitutional system, the Government of Puerto Rico (“Government”) has three branches: executive, legislative and judicial. The Chief of State is the President of the U.S., and the Head of Government is a Governor democratically elected every four years, who exercises Executive Power and leads a cabinet conformed by the heads of the Government’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 U.S. law is involved. The major differences between Puerto Rico and the 50 states are exemptions from some aspects of the United States Internal Revenue Code (“US Tax Code”), its lack of voting representation in the U.S. Congress, and the ineligibility of the people of Puerto Rico to vote in the U.S. presidential elections.

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

Language

The official languages of the executive branch of the Government are Spanish and English. Although Spanish is spoken more commonly, business is frequently conducted in English. All U.S. federal matters are 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. Approximately 25% of the population speaks English, and the language is spoken in all major tourist areas.

Business hours and time zone

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

The working hours in Puerto Rico in the private sector are generally from 8:00am/9:00am to 5:00pm/6:00pm, with a break for lunch of 1-hour, from Monday through Friday.

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

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

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

Public holidays

Puerto Rico celebrates religious, local and U.S. holidays. The following holidays are observed in Puerto Rico, provided that if the holiday falls on a Sunday is observed on the following Monday:

Holiday	Date
New Year's Day	January 1
Epiphany - Three Kings' Day	January 6
Martin Luther King Day	Third Monday of January
President's Day	Third Monday of February
Emancipation Day	March 22
Good Friday	March or April
Easter Sunday	March or April
Memorial Day	Fourth Monday of May
US Independence Day	July 4
Puerto Rico's Constitution Day	July 25
Labor Day	First Monday of September
Columbus Day	October 12
Election Day	The fourth Tuesday of November, every four years
Veteran's Day	November 11
Puerto Rico's Discovery Day	November 19
Thanksgiving Day	Fourth Thursday of November
Christmas Day	December 25

Economy

Diversification of the economy, coupled with investments and funding from the U.S., has created an economic environment that does not rely solely on tourism for financial prosperity. A diverse industrial sector has surpassed agriculture as the primary source of economic activity and income.

Encouraged by duty-free access to the U.S. and competitive tax incentives, U.S. business have invested heavily in Puerto Rico since the 1950s. Furthermore, following recent tax incentives focused on export of services, Puerto Rico is betting to surpass the current economic challenges by promoting Puerto Rico as an international hub of export services, with a high concentration on technology and novel industries.

Tourism continues to be an important source of income.

Economic growth

Over the last years, Puerto Rico's economy has suffered a standstill in its economic growth due to the ongoing recession. Although economists' analyses tend to believe that this reduction in the economy has ceased, the prospects for the year 2021, and future years, tend to be clouded by the fact the island's economy is not isolated from the rest of the world.

Nevertheless, Puerto Rico has the ability for achieving sustainable development in its manufacturing and advanced services foundations, its skilled workforce, and the fact that there is little to no country risk.

Employment levels

The island's top-notch labor force has become the primary asset of Puerto Rico's diverse manufacturing sector and continues to be one of the main reasons established companies continue to operate locally and new ones are drawn to the island.

According to the Puerto Rico Department of Labor and Human Resources, as of December 2017:

- Puerto Rico's labor-force participation rate was at 40.1%;
- Employment was 1.104 million people strong, a decrease of 14,000 when compared with December 2016; and
- There were 119,000 people unemployed for an unemployment rate of 10.8%, a reduction from the 11.8% in December 2016.

Living standards

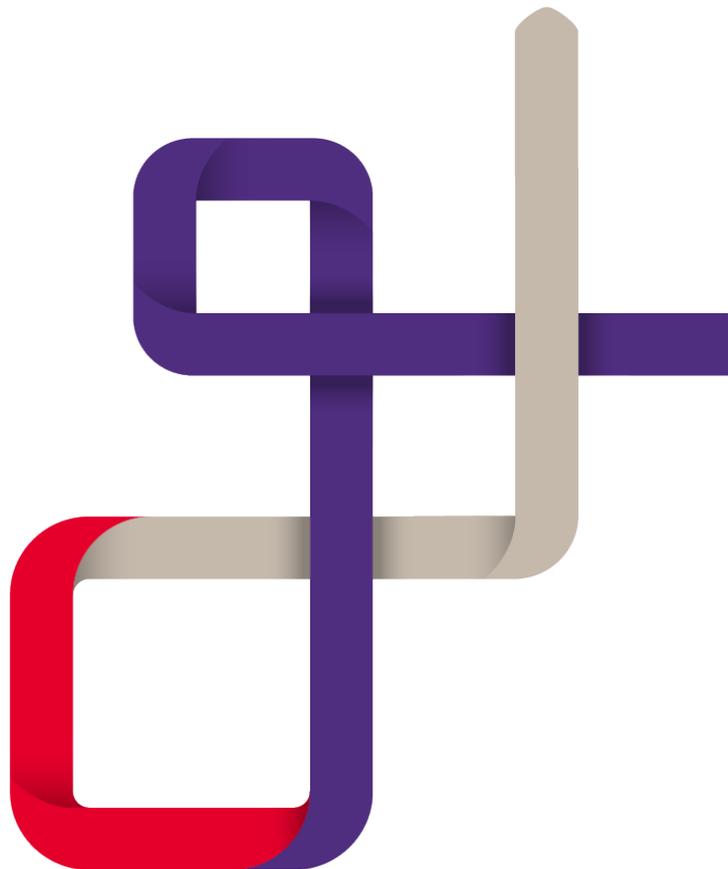
Since Puerto Rico is a territory of the U.S., minimum wage laws apply.

Cost of living

According to the Council for Community and Economic Research (C2ER), as of September 2019, the cost of living in Puerto Rico is approximately 13% higher than in the U.S. in average.

In comparison with the U.S. average, grocery prices are 18.9% higher, utilities are approximately 54% higher, and housing and transportation are slightly lower.

The average cost of healthcare in Puerto Rico is 31.6% below the average cost of healthcare in the mainland.



Visas

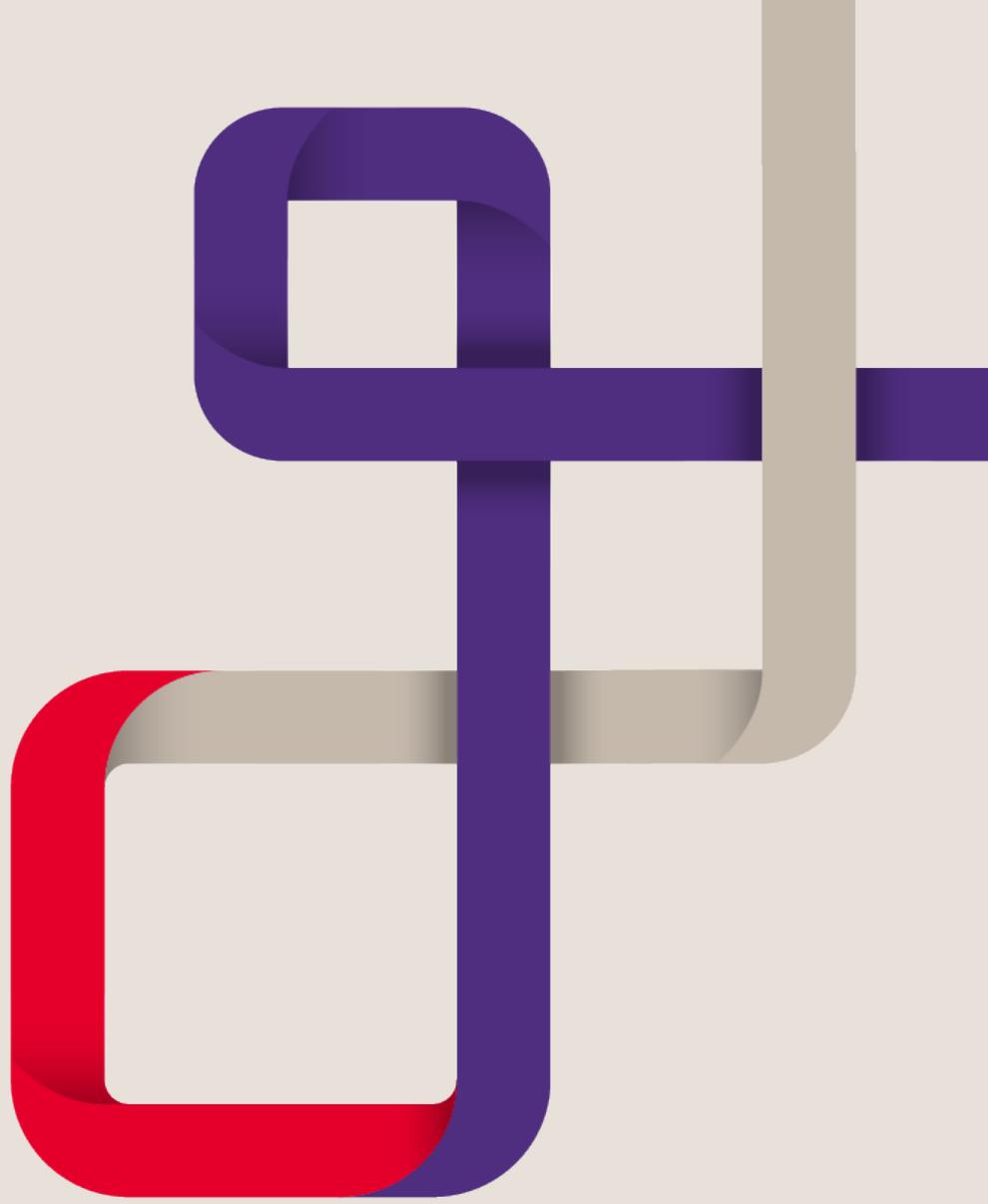
As U.S. territory, immigration and work visas in the island are governed by federal law, through the U.S. Department of Homeland Security's Citizenship and Immigration Services. Foreign nationals with a Green Card, who become permanent U.S. residents, are permitted to work indefinitely in U.S., including Puerto Rico. In addition to permanent residents, U.S. laws allow some foreign nationals to work in its States, Territories or Possessions.

Expatriates taking up employment in Puerto Rico are subject to comprehensive tax and employment visa requirements. As such, any foreign national who wants or needs to work in Puerto Rico on a temporary basis (that is, they will not obtain permanent residence) must be certified by the U.S. Department of Labor. A petition from a Puerto Rico employer must generally be attached to the visa application. An individual holding a temporary visitor's visa cannot be employed by a Puerto Rico employer. When the expatriate is a U.S. citizen, the above procedures are not required.

Below are permanent worker visa preference categories:

Preferences	General description	Labor certification required?
First Preference EB-1	Reserved for individuals of extraordinary ability in the sciences, arts, education, business, or athletics; outstanding professors or researchers; and certain multinational executives and managers.	No
Second Preference EB-2	Reserved for individuals who are members of the professions holding advanced degrees or for individuals with exceptional ability in the arts, sciences, or business.	Yes, unless applicant can obtain a national interest waiver
Third Preference EB-3	Reserved for professionals, skilled workers, and other workers.	Yes
Fourth Preference EB-4	Reserved for "special immigrants," which includes certain religious workers, special immigrant juveniles, broadcasters, G-4 international employees of the U.S. Government abroad and other classes of aliens.	No
Fifth Preference EB-5	Reserved for business investors who invest \$1.8 million or \$900,000 (if the investment is made in a targeted employment area as designed by the government of the U.S.).	No

For additional information please visit the U.S. [Citizenship and Immigration Services website](#).



Regulatory environment

Regulatory environment

Restrictions on foreign ownership

Title and rights of ownership may be held and exercised by one or more persons, natural or juridical (“Person”), including foreign Persons.

Government approvals and registration

All Persons seeking to be engaged in trade or business in Puerto Rico, must register with the Registry of Businesses at the Puerto Rico Department of Treasury (“PR Treasury”) prior to commencing business operations.

Competition rules and consumer protection

The Puerto Rico Department of Consumer Affairs or DACO for its Spanish acronym, aims to defend and implement the rights of the consumer, restrain inflation, and oversee prices on consumer goods and services. DACO has the power to impose administrative fines, issue subpoenas, and represent the public consumer.

Import and export controls

U.S. export controls restrict a wide array of items; except for exports to U.S. Territories and Possessions, all exports from the U.S. are subject to an export “license”.

Price controls

Price control matters in Puerto Rico are typically regulated by DACO.

Use of land

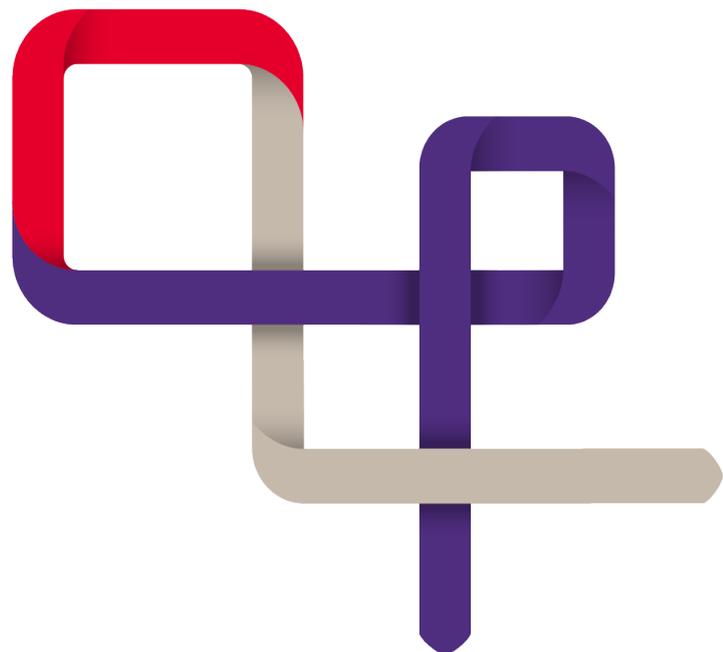
The Puerto Rico Planning Board and the Permits Management Office or OGPe for its Spanish acronym, are the agencies responsible for the regulation of economic planning and land use zoning in the island. Counterpart offices exist in the 78 municipalities.

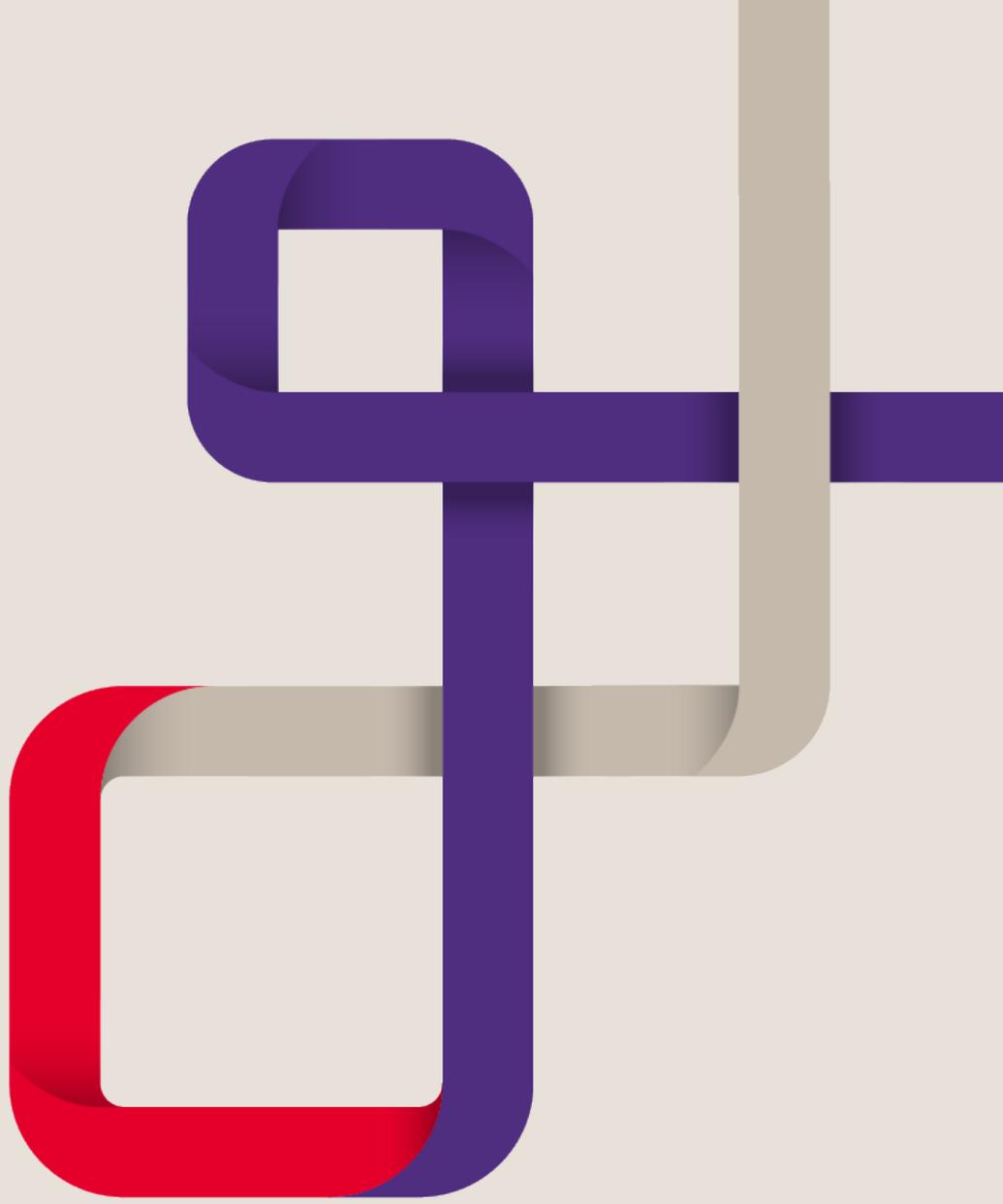
Exchange control

Puerto Rico does not have any exchange control regulations.

Government incentives

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





Insurance

Insurance

Overview

The Puerto Rico Insurance Commissioner's Office or OCS for its Spanish acronym, is the Puerto Rico agency responsible for safeguarding the public interest, ensuring the solvency of insurers and health insurance organizations. The OCS is also responsible for addressing situations referred by consumers and ensuring full compliance with regulatory requirements.

Title 26 of the Laws of Puerto Rico Annotated ("L.P.R.A."), governs the insurance sector.

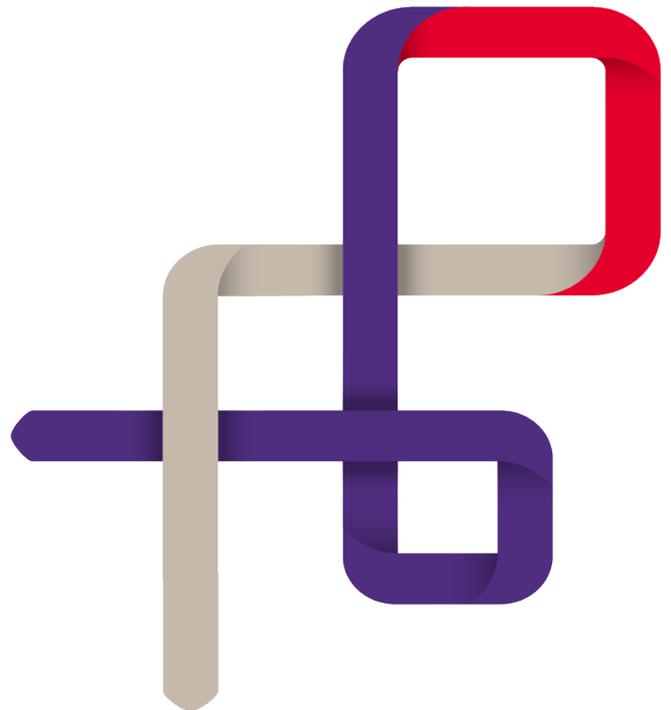
Important Puerto Rico Insurance Code provisions

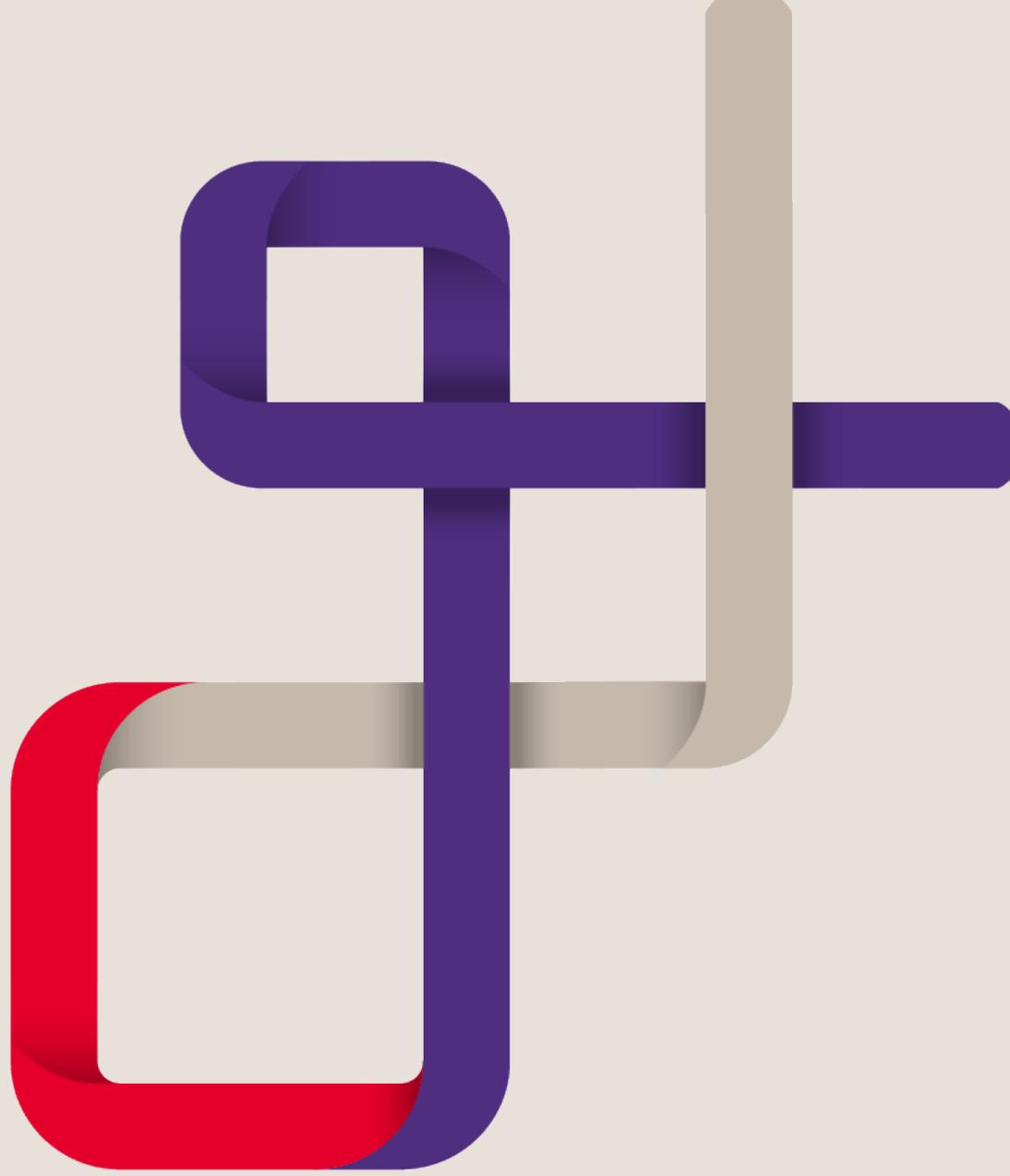
According to the OCS, the following legal entities must be licensed:

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

Mandatory insurance requirements

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





Finance

Finance

Summary

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

Banking system

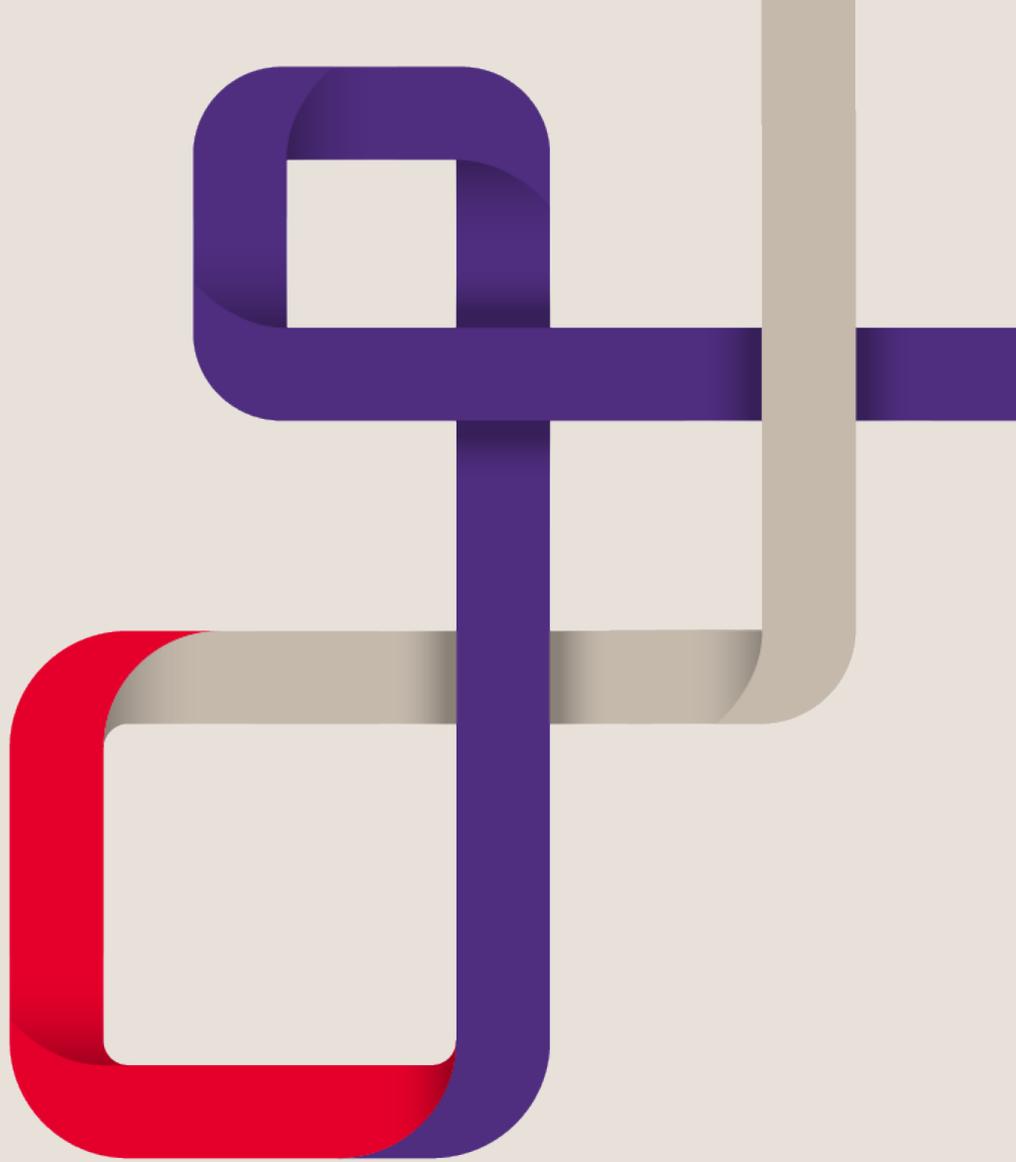
Puerto Rico's banking system is regulated under U.S. laws by the Federal Deposit Insurance Corporation (FDIC). Commercial banks organized in Puerto Rico are governed by the Puerto Rico Banking Act. Based on their circumstances, banks organized in Puerto Rico or doing business in Puerto Rico are also subject to various federal banking laws, and the supervision of various federal banking agencies.

Capital markets

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

Other sources of finance

The Economic Development Bank of Puerto Rico serves as a bank that provides financial assistance to private small and medium sized business (PyMES for its Spanish acronym) from different economic sectors. Its main goal is to assist PyMES to create, develop, produce, and implement activities that promote economic development in the island, and foster job creation.



Imports

Imports

Summary

The U.S. is the main trading partner of Puerto Rico and accounts for nearly 90% of its exports and 54% of its imports.

Pharmaceuticals, chemicals, petroleum products, food, computer and electronic products, machinery, motor vehicles, plastics, and rubber products, are among the main items constituting Puerto Rico imports.

Import restrictions

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

Customs duties

Import duty and taxes are due when importing goods into Puerto Rico whether by a private individual or a legal entity. The valuation method is Free on Board (FOB) which means that the import duty payable is calculated exclusively on the value of the imported goods. However, some duties are based part in value and part in quantity.

In addition to duty, imports may be subject to sales and use tax (SUT) or excise taxes.

Duty rates can be *ad valorem* (as a percentage of value) or specific (dollars/cents per unit).

Duty rates vary from 0% to 37.5%, with the average duty rate being 5.63%.

Basic data

Imports

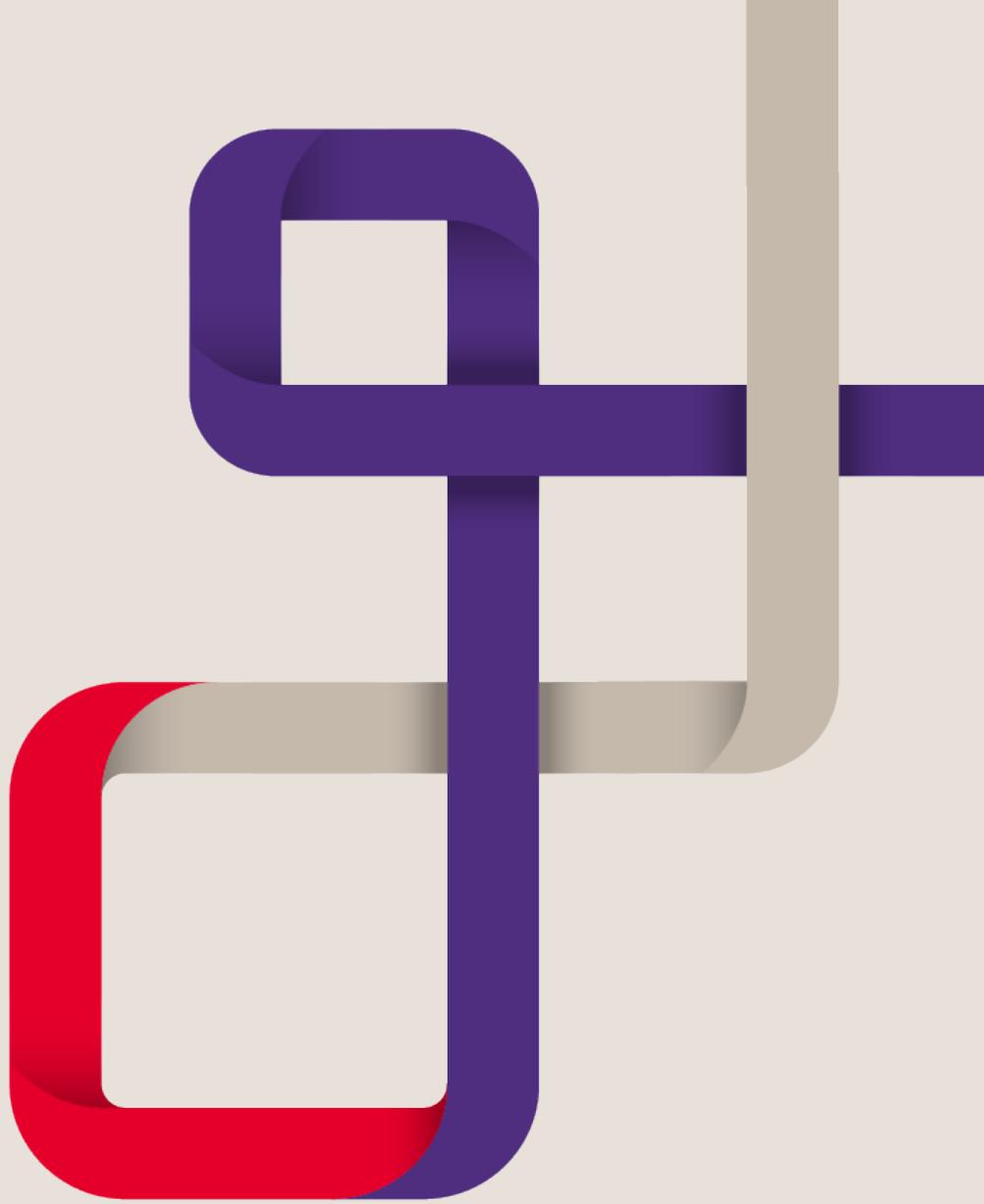
\$46.5 billion (2018)

Imports – commodities

Pharmaceuticals, chemicals, petroleum products, food, computer and electronic products, machinery, plastics and rubber products, electrical equipment

Imports – partners

USA, Ireland, Switzerland, Singapore, and South Korea.



Business entities

Business entities

Summary

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

Sole proprietorships

A sole proprietorship is a business owned by an individual who chooses not to form a legal entity (“Entity”). For purposes of this guide, the term “Entity” includes corporations, limited liability companies, partnerships, real estate investment trusts, business trusts, non-for-profit corporations, among others.

There are no special legal requirements for operating as a sole proprietorship other than the normal requirements for starting a trade or business, including obtaining an Employer Identification Number for those sole proprietorships with employees other than the owner, and registering with the Registry of Businesses at the PR Treasury.

Sole proprietorships are not Entities and cannot enter into contracts or sue or be sued in their own name. Accordingly, a sole proprietorship provides no liability shield to its owner and, generally, terminates upon the death of its owner. Likewise, it is not taxed separately, and all income and expenses are recognized by the owner. The owner is taxed at the applicable individual tax rates.

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

Partnerships

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

Under the provisions of the Puerto Rico Internal Revenue Code, as amended (“PR Tax Code”), partnerships are pass through Entities. Rules similar to those applying to partnerships under the US Tax Code were adopted.

Civil Code partnerships

A Civil Code partnership is a contract by which two or more individuals bind themselves to contribute money, property, or industry to a common fund or enterprise, with the intention of dividing the profits among themselves.

A Civil Code partnership is created through a private agreement between the parties, unless there is contribution of real property, in which case the partnership must be created through a Public Deed. The partnership does not need to register with any governmental agency to be created or constituted.

Commercial Code partnerships

Commercial Code partnerships (partnerships formed under the provisions of the Puerto Rico Commerce Code) are those in which two or more individuals obligate themselves to join funds, property, or industry to obtain profits. This definition is almost identical to the definition of a Civil Code partnership, provided the Commercial Code partnership must meet certain formal requirements, including being executed in a Public Deed and registering with the Mercantile Registry (failure to record eliminates the protection of the partnership contract as to third-party claims).

The recording fee in the Mercantile Registry is \$1.00 per \$1,000 of capital, up to \$10,000 and 50¢ per \$1,000 above \$10,000. The Mercantile Registry only acts as a registry and has no supervisory duties. There is a Mercantile Registry in each Property Registry, and partnerships must be recorded in the Registry located in the municipality where the principal office of the business is located.

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

A **limited partnership** is made up of managing and limited partners. Managing partners run the affairs of the partnership and are jointly liable for the debts and obligations of the partnership. Limited partners are passive investors and may not participate in the management of the partnership, and their liability for the debts and obligations of the partnership is limited to their contribution to the partnership. However, a limited partnership cannot include the name of a limited partner; if it does, the limited partner may be held jointly liable with the managing partners for the liabilities of the partnership.

Limited liability partnerships (LLPs)

Two or more individuals, including those rendering professional services, can form an LLP in Puerto Rico. The LLP must register with the Puerto Rico Department of State, by filing a certified copy of the constituent Public Deed, accompanied by a \$110 registration fee. Registration is valid for one year and must be renewed annually by filing a renewal application for \$110. The name of the LLP must include the words “limited liability partnership”, “sociedad de responsabilidad limitada”, “LLP”, “L.L.P.”, “SRL” or “S.R.L.”

Generally, a partner in an LLP is not personally liable for the debts and obligations of the LLP, or for negligent or unlawful acts of another partner or employee not supervised by the partner, provided the partner had no prior knowledge of the acts. However, a partner may be held personally liable for the LLP’s 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 individual under their control or supervision or of which that partner had notice or knowledge.

Creating a domestic Entity

Puerto Rico’s Act No. 164 of 2009, as amended, known as the General Corporations Act, is based on Delaware’s law. Puerto Rico’s Act provides for the creation of for-profit, not-for-profit, domestic, foreign, close, professional service corporations, and limited liability companies (LLCs).

In general, the Entity may be organized by one or more Persons, are separate from their shareholders, members, directors, and officers, have the power to enter into contracts, hold property, and sue and be sued on their own name; they also have continuity of life and free transferability of ownership.

A typical structure consists of three main groups: directors, officers, and shareholders. In the most basic terms, the Entity is owned by its shareholders or members, they choose the directors, and the directors are charged with overseeing the management of the Entity, which is handled by the officers. Directors must carry out their duties in good faith and without conflicts of interest; officers must perform their obligations reasonably and in good faith.

The liability of directors and officers may be indemnified by the Entity. The liability of shareholders or members for the acts of the Entity, except in certain cases, is limited to their investment in ownership.

Any Person can form an Entity by filing articles of incorporation or organization, signed by the incorporator with the proposed Entity’s name, street address, business purpose, incorporators’ name and authorization, stock or units’ information, and directors’ names and address, with the Corporate Division of the Puerto Rico Department of State, along with a \$150 filing fee for corporations or \$250 for LLCs.

De facto corporations are not contemplated under the Puerto Rico General Corporations Act.

If shares or units have been issued, the articles of incorporation or organization can be amended by the Board of Directors or members, as the case may be. If no shares or units have been issued, the articles of incorporation or organization can be amended by the directors (if they have been named) or the incorporators (if the directors have not been named).

The management of a corporation is typically carried out pursuant to its bylaws (operating agreement in case of an LLC), which may be adopted or amended at incorporation by the incorporator, thereafter by the shareholders or members, or, if permitted by the articles of incorporation or organization, by the directors.

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

Ownership of an Entity is altered through ownership of stock or units, which may be issued in various classes with various rights and restrictions. Stock or units are considered personal property. Shareholders or members typically must hold meetings at least once per year. The Act identifies certain actions, and the articles of incorporation or organization may specify others, that must be approved by the shareholders, partners, or members. Nonresident individuals of Puerto Rico, and noncitizens of the U.S., may own stock or units and serve as directors and officers of a Puerto Rico Entity.

Funding the Entity

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

When an Entity assumes the liabilities of the transferor or receives property from the transferor subject to liabilities, the 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, units or securities received by transferors.

The basis of the stock, units, or securities received by a transferor in a nonrecognition exchange with an Entity 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 Entity is treated as money received by the transferor for the purpose of determining the basis of the stock, units, or securities received by the transferor.

Reorganizations

Generally, the reorganization rules under the PR Tax Code follow a pattern similar to that rules of the US Tax Code, with the principle that no gain or loss is recognized because the new structure is merely a continuation of the previous structure. The recognition of gain or loss is postponed by means of a carryover of the basis.

The PR Tax Code lists the same types of reorganizations as the US Tax Code, except the PR Tax 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 PR Tax 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 is recognized upon the liquidation of an Entity, at both, the Entity and shareholder, partner, or member levels.

At the Entity level, the liquidation is treated as if the assets are being sold to the shareholder, partner, or member at fair market value. At the shareholder, partner, or member level, the liquidation is treated as an exchange by the shareholder, partner, or member, of its shares of stock, interest, or units for the assets received from the Entity.

Thus, a gain or loss is recognized based on the difference between the fair market value of the assets received and the adjusted basis of the shares of stock, interest, or units being surrendered.

No gain or loss is recognized upon the complete liquidation of a controlled subsidiary into its parent. In this case, control is the ownership of at least 80% of the total combined voting power and total number of shares of all other classes of stock, interest, or units.

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.

Stock with step-up in basis of assets of acquired Entity

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.

Dissolutions

Dissolution of an Entity is accomplished by following the procedures established in the Puerto Rico General Corporations Act. This process includes the filing of a Certificate of Dissolution with the Puerto Rico Department of State and the withdrawal from the several governmental agencies in which the dissolved Entity holds a filing requirement.

Corporations

Corporations must file an annual report on or before April 15. If the annual volume of business exceeds \$3,000,000, it must accompany the annual report with the Balance Sheet at the close of the preceding fiscal year, audited by a Certified Public Accountant ("CPA") licensed in Puerto Rico who cannot be a shareholder or employee of the corporation. Each annual report is filed on an annual basis and must be accompanied by a filing fee of \$150.

Corporations can merge or consolidate with one another (in a merger, one of the corporations survives; in a consolidation, a new corporation is formed). In either event, the shareholders and creditors of the non-surviving corporations become shareholders 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.

Close corporations

Closed corporations provide structural flexibility to Entities owned by a relatively small number of shareholders that do not intend to go public within a short period of time.

To qualify as a close corporation, the certificate of incorporation must include, among other clauses, provisions stating that:

- the number of shareholders does not exceed 75 individuals; and,
- all of the issued stock of all classes is subject to one or more of the following restrictions regarding the transfer of shares:
 - a right of first refusal;
 - an obligation on the part of the Entity, any shareholder or any third party to purchase the shares subject to a purchase-sale agreement;
 - the requirement of the consent of the Entity 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 individuals or classes of individuals.

In addition, the Entity shall not make any public offering that qualifies as such under the U.S. Federal Securities Act of 1933.

Professional service corporations (PSCs)

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

Officers, employees, and agents of the PSC are fully and personally liable for any negligent act or omission, unlawful act, or for any wrong conduct that arises from the rendering of professional services on behalf of the PSC, whether committed by such officer, employee, or agent or by any individual under their direct supervision or control.

The PSC is held jointly liable up to the aggregate value of its assets for the negligent or unlawful acts or for the wrong conduct of its officers, employees, and agents while offering professional services on behalf of the PSC. However, shareholders who were not involved in the negligent or unlawful act or omission or wrong conduct are not personally liable for the damages caused by them.

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

The annual report of a PSC must certify that its shareholders, directors, and officers are duly licensed, certified, and registered to render the professional services of the PSC in Puerto Rico. Foreign Entities do not qualify as PSCs.

Not-for-profit Entities

The Puerto Rico General Corporations Act provides for the organization of not-for-profit Entities.

The certificate of incorporation must clearly state that the Entity is organized for not-for-profit purposes and is not authorized to issue stock or units.

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

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

Limited liability companies (LLCs)

Any Person may organize an LLC in Puerto Rico. The articles of organization are required to be filed with the Puerto Rico Department of State, where it becomes available for public inspection. Every LLC is required to maintain in Puerto Rico a registered office and a resident agent, who can be a bona fide individual resident of Puerto Rico, a domestic Entity, or a foreign Entity authorized to do business in Puerto Rico. The required registration fee is \$250.

For income tax purposes, LLCs are taxed in the same manner as corporations. Nevertheless, LLCs may choose to be treated as partnerships by filing Form AS 6045, titled "Partnership or LLC Classification Notification or Election", with the first income tax return filing for the year the LLC is electing to be treated as a partnership.

However, if an LLC organized under the laws of the U.S. or other foreign country is treated as a pass-through or disregarded entity for income tax purposes, it is treated as a pass-through Entity for Puerto Rico income tax purposes. This exception does not apply to those LLCs that were operating under a Decree of Tax Exemption as of the date of effectiveness of the PR Tax Code (i.e., January 1, 2011).

Corporation of individuals ("N Corporation")

A domestic corporation owned by 75 or less individuals, if certain requirements are met, may elect to be treated as a corporation of individuals for Puerto Rico income tax purposes. This tax treatment allows the pass-through of income and losses to the owners, thus eliminating the double taxation of income.

To qualify, 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 includes for these purposes, a U.S. corporation which is solely engaged in a trade or business in Puerto Rico.

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, so they may dispose of it as directed by the party who transfers the property, named constituent, for their 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 Persons who agree to undertake economic activity together and share in the revenues, expenses, and control of the enterprise. The venture can be for one specific project only, or a continuing business relationship.

For income tax purposes, it is treated as a partnership.

Cooperatives

A cooperative is a not-for-profit Entity founded by a group of private individuals 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 are formed by a minimum of eight individuals (except workers cooperatives which only need 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 are met, the documentation may be submitted to the Puerto Rico Department of State for registration. The cooperative is duly constituted when the Puerto Rico 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 11 individuals.

Examples of the many types of cooperatives include:

- youth cooperatives;
- labor cooperatives;
- housing cooperatives;
- production credit cooperatives;
- consumer cooperatives;
- farm machinery cooperatives; and
- savings and credit cooperative unions.

Some types of cooperatives have their own special requirements.

International financial entities (IFE)s

The concept of IFEs was originally introduced in Puerto Rico by Act No. 52 of 1989. International banking entities ("IBEs"), as these Entities were known then, received a different tax treatment than the one granted 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 Decree of Tax Exemption in the nature of a contract between the Government and the IBE.

The primary purpose of IFEs is to attract U.S. and foreign investors to Puerto Rico. Also, contrary to other financial institutions, IFEs are allowed to enter into transactions with the Government Development Bank of Puerto Rico, the Economic Development Bank of Puerto Rico, the Government, deposit funds in Puerto Rico banks, participate in local loan syndications and purchase substandard or nonperforming loans from Puerto Rico Entities.

Consequently, IFEs were authorized to engage in traditional banking and financial transactions, principally with nonresidents of Puerto Rico. Furthermore, the scope of eligible IFE activities encompasses a wider variety of transactions than those previously authorized to IBEs.

An existing IBE can continue operating under Act No. 52 of 1989, or it can voluntarily convert to an IFE, so that it may broaden its scope of eligible transactions and obtain a Decree of Tax Exemption.

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

Insurance companies

Insurance companies include any Person engaged in the business of issuing insurance policy contracts, as defined in the Puerto Rico Insurance Code ("Insurance Code").

The Insurance Code, as well as the regulations issued thereunder by the Puerto Rico Insurance Commissioner, establish a series of requirements for an insurance company to operate in Puerto Rico, such as:

- funds;
- deposits;
- capital or surplus; and
- investment in Puerto Rico securities, among others.

Real estate investment trusts (REITs)

A REIT is a tax designation reserved for Entities investing in real property that reduces or eliminates corporate income taxes.

The term "real property" includes, among other things:

- hospitals and related facilities;
- schools and/or universities;
- public and private housing;
- transportation facilities and private or public roads;
- office and residential buildings;
- buildings occupied by the Government;
- recreational centers;
- parking facilities;

- shopping facilities and centers, including warehouses;
- buildings purchased from the Government; and
- hotels.

To qualify as a REIT, the PR Tax Code requires the Entity to:

- be organized as a corporation, partnership, trust, or association;
- have 20 or more shareholders, partners, or members 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 taxed as a domestic corporation for Puerto Rico income tax purposes;
- not qualify 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
- not be, at no time during the last half of its taxable year, more than 50% of the total value of all outstanding shares or participation certificates can be owned by less than five individuals.

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

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

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

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

derived from, the sale or other disposition of shares of transferable stock, certificates, or participation in another REIT;

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

REITs organized under U.S. law or any of its states ("USREITs") must meet the following requirements to be treated as a REIT under the PR Tax Code:

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

Registered investment companies

Investment companies are engaged primarily in the business of investing, reinvesting, or trading in securities. They may be organized as corporations, partnerships, associations, joint stock companies, trusts, funds, or any organized group of individuals, 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 U.S. government, the Government, 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 the securities; and
- offers its securities to the general public if its outstanding securities are owned by more than 100 individuals.

An investment company must register with the Puerto Rico 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, unless otherwise authorized; and
- have a net worth of at least \$100,000 or insure that after registration it will not issue any of its shares until firm agreements are made by not more than 25 individuals to purchase and pay an aggregate net amount that, added to the net worth of the company, will equal at least \$100,000.

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

Special employee-owned corporations (SEOCs)

SEOCs are a hybrid between a corporation and a cooperative. SEOCs are owned and controlled by “members”, 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 individuals who are employed by the SEOC in an indefinite full-time or part-time work relationship, and who render their services directly, may be admitted as regular members;
- must have at least three regular members who are not related within the 4th degree of consanguinity and 2nd 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. 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 Puerto Rico Department of State. The initial capital of a SEOC is \$1,000. A SEOC may not issue common stock or any other type of voting stock. All the voting power of an SEOC is in its members. However, an SEOC may issue preferred stock (without voting power) and bonds like a regular corporation; and
- is considered a for-profit corporation. The regular members of an SEOC are considered self-employed in relation to labor-protective legislation, except for purposes of workmen’s compensation laws and the Puerto Rico Employment Security Act.

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

Individuals that may qualify as special members are:

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

Registering a foreign Entity

All Entities that are not organized under the laws of Puerto Rico, are considered foreign.

Prior to conducting business in Puerto Rico, foreign Entities must register with the Puerto Rico Department of State, which will usually allow them to do business in Puerto Rico, so long as the proposed business is permitted and no other Entity is doing business under the same name.

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

The fees required by the Department of State to process and issue the certificate of registration are \$150. Legal process against the Entity may be served on its authorized resident agent, who can be a bona fide individual resident of Puerto Rico or a domestic Entity, but cannot be a shareholder, member, officer, or director of the Entity.

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

Subsidiary

As previously mentioned, a foreign Entity may be engaged in trade or business in Puerto Rico as a division or branch of that foreign Entity, or as a separate Entity or subsidiary.

A foreign Entity that is engaged in 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; and
- 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 evidence of indebtedness that is either derived from a banking or financing business or from an Entity 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 Entity'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 subsidiary is allowed to deduct the expenses directly allocable to the Puerto Rico operations. In addition, a reasonable apportionment of expenses not directly related to any item of income is allowed as a deduction.

Nevertheless, the PR Tax Code allows for the disallowance of 51% of the expenses or charges incurred by an Entity, 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 tax. However, if the Entity includes a Transfer Pricing Study with the income tax return, including an analysis of the Puerto Rico operations in compliance with the requirements set

forth in Section 482 of the US Tax Code, then the Entity is exempt from the 51% disallowance.

Any actual repatriation of profits (i.e., dividends) is subject to a 10% income tax withholding at source, and for purposes of filing the U.S. 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 subsidiary and the amount of earnings and profits, a deemed dividend maybe imposed.

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

A foreign Entity 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 choose 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 Entity not engaged in trade or business in Puerto Rico is 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 causes any other income received by the foreign Entity not engaged in trade or business in Puerto Rico to be treated as income effectively connected to a trade or business in Puerto Rico.

As for foreign subsidiaries, for years beginning after December 31, 2012, certain limitations to these deductions have been enacted.

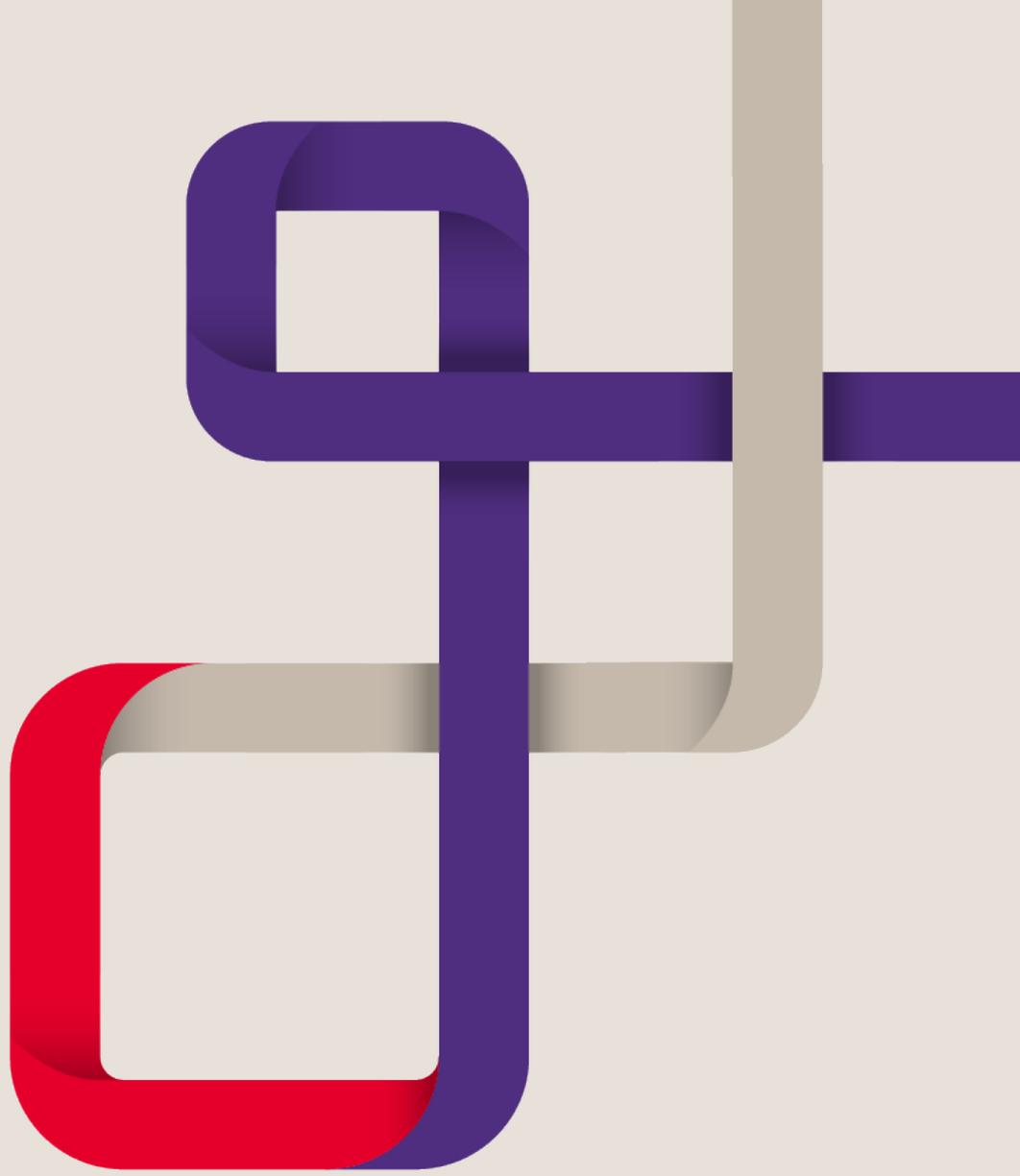
Branch

Income taxation of a branch is the same as for a subsidiary. The only difference is that a deemed dividend distribution tax (known as the branch profit tax or BPT) is 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 are 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 Entity is not subject to BPT 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 considers items of income effectively connected with the conduct of a trade or business in Puerto Rico. The branch is allowed to deduct the expenses directly allocable to the Puerto Rico operations. In addition, a reasonable apportionment of expenses not directly related to any item of income are allowed as a deduction.



Labor

Labor

Summary

The Puerto Rico Department of Labor and Human Resources is the primary government agency responsible for establishing and implementing labor and employment laws on the island.

Both, the federal and local labor, and employment laws, apply in Puerto Rico. The U.S. Department of Labor administers federal labor laws. The U.S. Equal Employment Opportunity Commission administers federal employment discrimination laws.

Puerto Rico's labor and employment laws are contained in Title 29 of the Laws of Puerto Rico Annotated (LPRA for its Spanish acronym), which defines the rights and obligations of employers and employees alike.

Salaries and wages

A series of federal and local wage and hour laws apply in Puerto Rico. The Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers in the private sector and in Federal, State, and local governments.

Covered, nonexempt workers are entitled to a minimum wage of \$7.25 per hour effective July 24, 2009. Nonexempt workers must be paid overtime pay at a rate of not less than one and one-half times their regular rates of pay after 40 hours of work in a workweek.

All employees of certain businesses having workers engaged in interstate commerce, producing goods for interstate commerce, or handling, selling, or otherwise working on goods or materials that have been moved in or produced for such commerce by any Person, are covered by the FLSA.

A covered enterprise is the related activities performed through unified operation or common control by any Person for a common business purpose and:

- whose annual gross volume of sales is not less than \$500,000 (exclusive of excise taxes at the retail level that are separately stated); or
- is engaged in the operation of a hospital, an institution primarily engaged in the care of the sick, the aged, or the mentally ill who reside on the premises; a school for mentally or physically disabled or gifted children; a preschool, an elementary or secondary school, or an institution of higher education (whether operated for profit or not); or
- is an activity of a public agency.

Payroll tax

Pursuant to the PR Tax Code, employers are required to withhold income tax at source upon the salaries and wages they paid to employees rendering services in Puerto Rico.

The withholding rate is reliant on the employee's personal exemptions and dependents credit claimed on the Certificate of Withholding Exemption, that must be completed by every employer for each employee. There is no salary or wage limitation for the withholding.

Withholdings

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

Pensions

The Employee Retirement Income Security Act of 1974 (ERISA) governs most types of employee benefit plans, including retirement plans, life and disability insurance, medical reimbursement plans, healthcare plans and severance policies.

ERISA requires certain reporting and disclosure, imposes fiduciary duties, and, for most types of retirement plans, establishes coverage, vesting and funding requirements.

Fringe benefits

Holiday pay

In Puerto Rico, a number of holidays are customarily recognized and paid. Employers typically are not subject to Act No. 1 of 1989, as amended, known as the Commercial Business Operations Regulatory Act, are not required to close during statutory holidays nor grant said holidays with or without pay.

Vacation and sick leave

Act No. 4 of 2017, known as the Labor Transformation and Flexibility Act, states that every employee is entitled to a minimum vacation and sick leave accrual after working at least 130 hours a month. The minimum monthly sick leave accrual rate for the employees is 1 day for every month. These provisions apply to newly hired employees.

An employer may increase up to 129 monthly work hours of any part-time employee, and the increase does not imply that the employee has a statutory right to accumulate vacations and sick leave.

One of the reasons established by the Act is to encourage employers to give part-time employees more hours of work monthly.

Retirement plan

Pursuant to the PR Tax Code, retirement plans can be divided into 2 types: (i) qualified plans and (ii) nonqualified plans.

Qualified plans are those specifically covered by the PR Tax Code. These plans offer a special tax treatment to: (i) the employer, who is allowed to deduct contributions made to the plan; (ii) the participants, who can defer taxation on 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.

Worker's compensation

All employers must obtain a workers' compensation insurance from the Puerto Rico State Insurance Fund Corporation or CFSE for its Spanish acronym.

The insurance policy provides compensation to employees for work-related accidents or conditions, including occupational diseases. There are exceptions (i.e., when an employee is injured as a result of attempting to commit a crime, being intoxicated, or engaging in reckless behavior). A covered employer is not subject to legal claims for employment-related accidents.

The Compensation System for Work Related Accidents Act protects the employee's right to reinstatement for 12 months after a work-related accident.

Healthcare

Both, U.S. and Puerto Rico laws and regulations governing health and safety in the workplace, apply to businesses operating in the island.

Both, the Occupational Safety and Health Act of 1970 (OSHA), and its equivalent in Puerto Rico, the Puerto Rico Occupational Safety and Health Act of 1975, impose an affirmative obligation among employers to provide a work-environment free from risks, which may cause death or physical harm to employees.

Employers are required to provide and ensure the use of protective personal equipment as required or as reasonably necessary, as well as to report serious accidents within 8 hours.

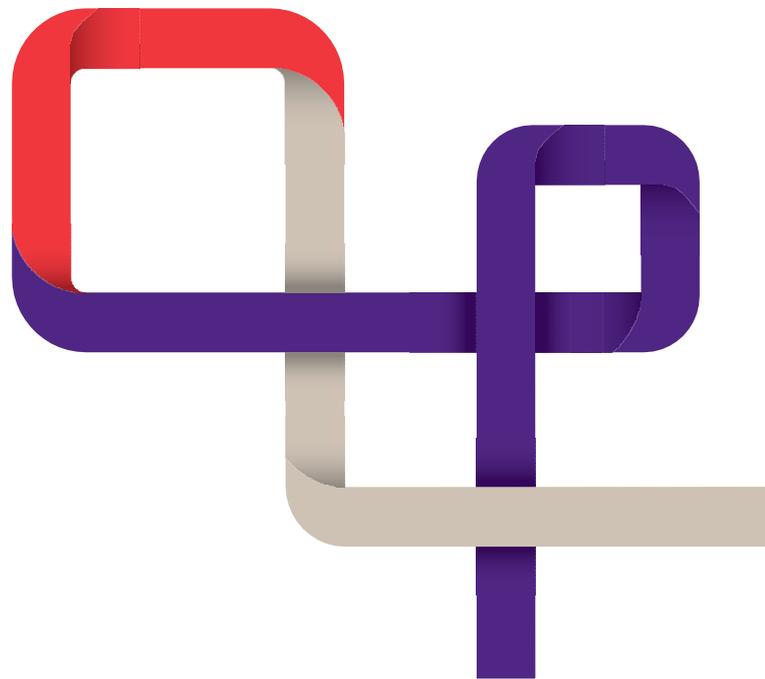
Employment protection legislation

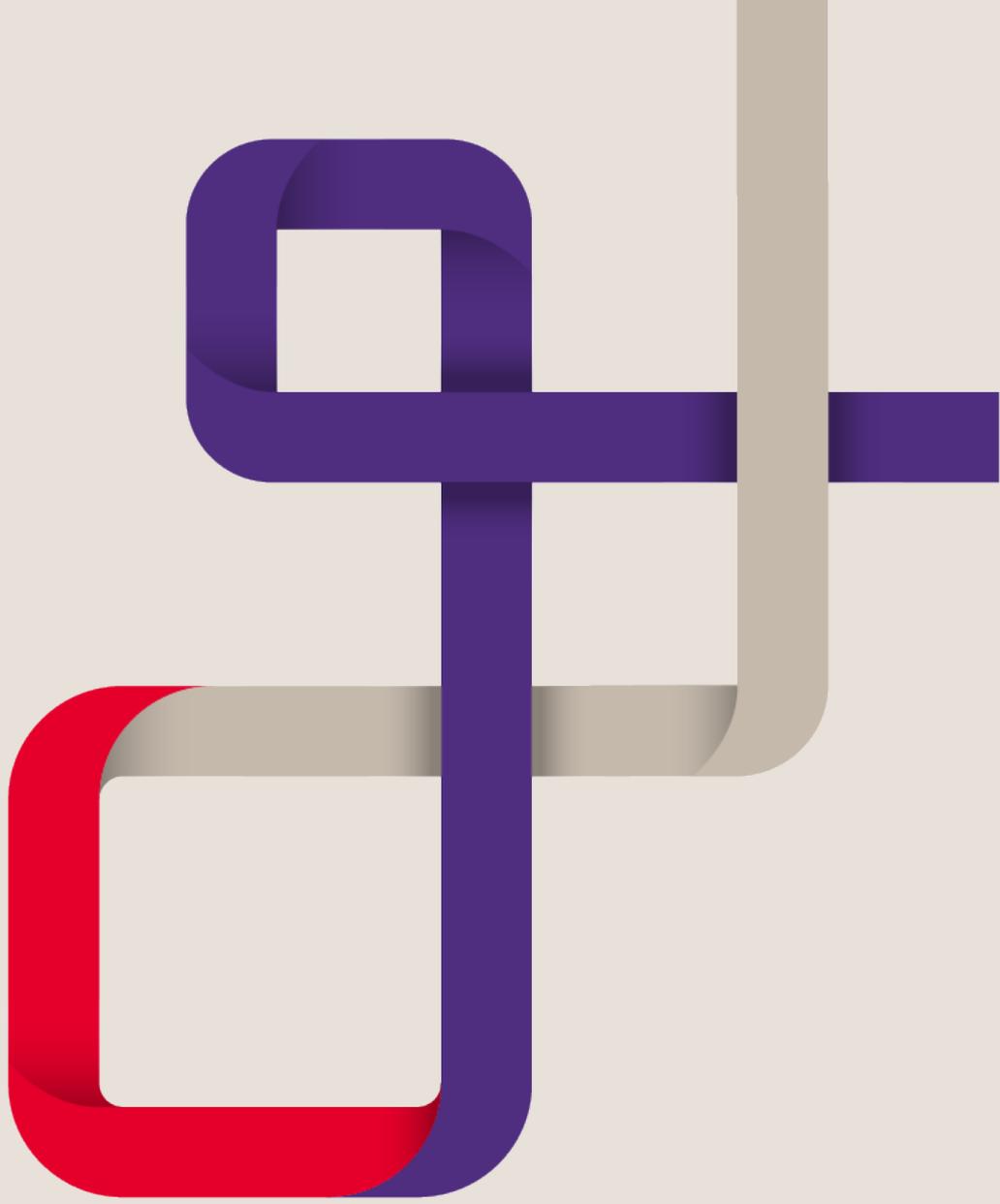
As a U.S. jurisdiction, Puerto Rico is subject to federal employment laws, including:

- Title VII (employers engaged in interstate commerce);
- Age Discrimination in Employment Act (ADEA);
- Americans with Disability Act (ADA);
- Equal Pay Act of 1963; and
- Title II of the Genetic Information Non-discrimination Act of 2008 (GINA), among others.

Unions

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





Financial reporting and audit

Financial reporting and audit

Summary

Puerto Rico employs the same accounting principles prescribed for financial statements as those prescribed in the U.S. by the Financial Accounting Standards Board (“FASB”) and predecessor Boards of the AICPA.

Filing requirements

Every Person engaged in a trade or business or in the production of income in Puerto Rico, must submit along with its tax returns, audited financial statements (“AFS”) prepared according to the U.S. Generally Accepted Accounting Principles (“U.S. GAAP”), together with an Auditor’s Report issued according to the U.S. Generally Accepted Auditing Standards (“U.S. GAAS”) pursuant to the rules set forth herein.

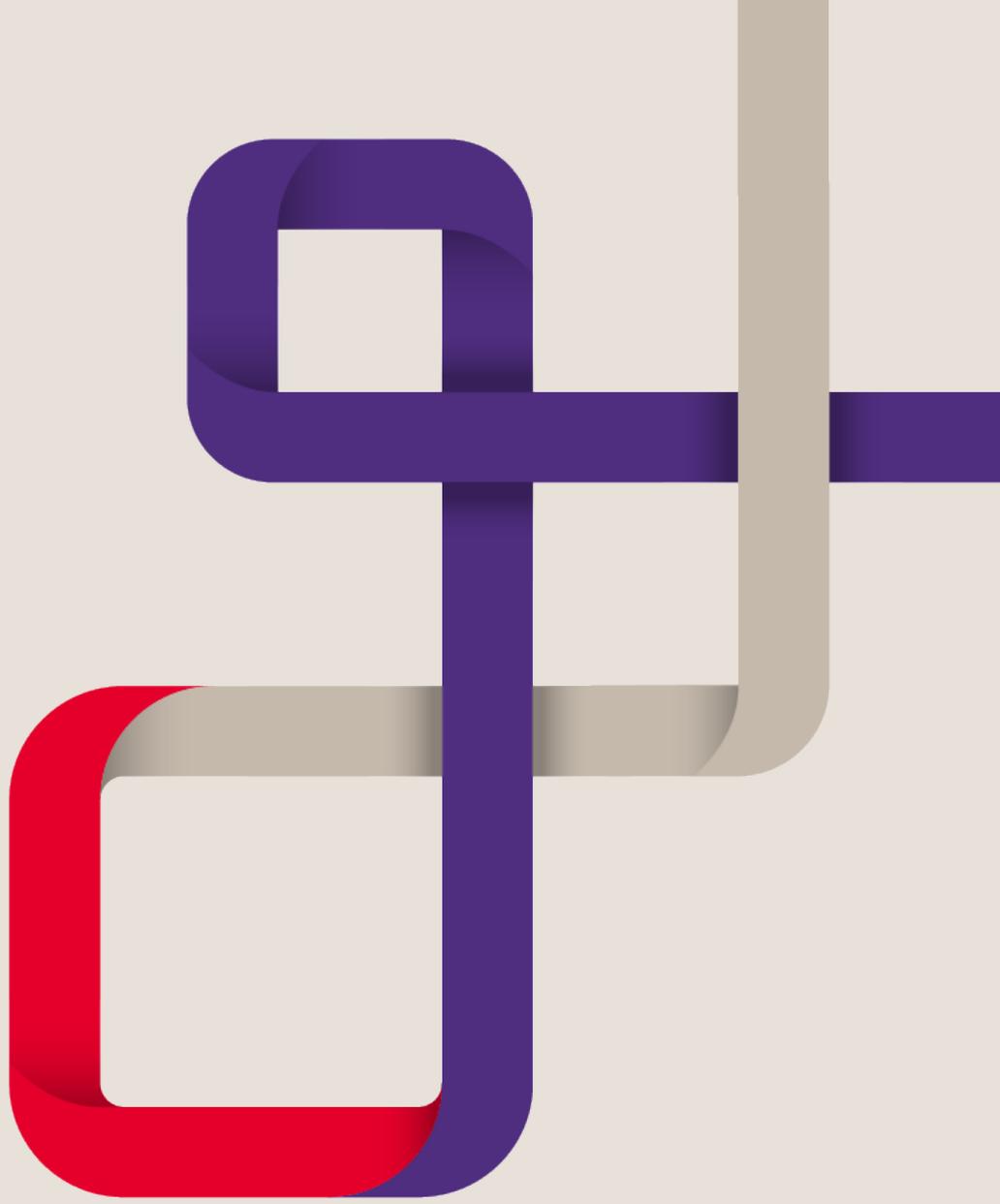
The income tax return requires to attach AFS if the volume of business is \$10,000,000 or more.

AFS should be attached to the Volume of Business Declaration for municipal license tax purposes (“patente”), annual report and personal property tax return when the volume of business is \$3,000,000 or more.

If a Person has a volume of business over \$1,000,000, it may opt to submit AFS to request a Certificate of Withholding Waiver. They also have the option to submit an Agreed Upon Procedures (“AUP”), not only for the Waiver, but also to be able to claim all deductions for AMT or ABT, as the case may be.

If the volume of business does not exceed \$3,000,000 (or \$1,000,000, if member of a controlled group or group of related entities) then the Person is not required to file AFS with the tax year’s income tax return. Instead, the Person may opt to submit an AUP to be able to claim all deductions for purposes of AMT or ABT.

Every controlled group of corporations or group of related entities, as the case may be, engaged in trade or business in Puerto Rico, must submit AFS for every Entity within the group with a volume of business of \$1,000,000 or more if the aggregate volume of the group is \$10,000,000 or more.



Individuals and corporate taxation

Individuals and corporate taxation

Summary

The PR Tax Code is the main body of domestic statutory tax law. It covers taxes such as income, payroll, gift, estate, sale, and use, among others.

Individuals

Tax year

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

Federal tax

Bona fide residents of Puerto Rico are subject to federal income tax on their worldwide income. However, Section 933 of the US Tax Code allows a bona fide resident of Puerto Rico to exclude Puerto Rico-source income for federal income tax purposes; provided they are subject to federal income tax on income from sources outside Puerto Rico.

The exclusion of Puerto Rico source income for federal income tax purposes, does not apply to the salary received by a U.S. government employee working in Puerto Rico, who must include federal income from work done in Puerto Rico as part of both, Puerto Rico, and federal income tax purposes.

Nevertheless, income tax paid by a U.S. government employee on salary to the PR Treasury may be credited against federal income tax liability, subject to certain limitations.

Residency

As stated above, Puerto Rico residents are subject to income tax on their worldwide income. Conversely, nonresidents are subject to Puerto Rico tax on their Puerto Rico-source income only. Thus, the determination of residency is of utmost importance.

For tax residency purposes, the PR Tax Code defines the term "resident individual" as an individual who is domiciled in Puerto Rico. It is presumed that an individual is a resident of Puerto Rico if they have been present in the island for a period of at least 183 days during the calendar year.

There are no current regulations issued under the PR Tax Code to clarify the definition of "resident individual". Furthermore, there is no guidance as to whether an individual can become a resident of Puerto Rico immediately after moving into Puerto Rico, or whether an individual can have a domicile in Puerto Rico for only one year.

Generally, if their intention regarding their stay is merely temporary and meets other requirements, even when they had been in Puerto Rico for 183 days or more, they may not be considered bona fide residents of Puerto Rico.

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

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

For federal income tax purposes, the US Tax Code has its own rules to determine whether an individual is considered a bona fide resident of Puerto Rico or not. Namely, the US Tax Code states three requirements that must be met:

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

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

Puerto Rico tax

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** – net long-term capital gains are subject to a 15% preferential tax. Capital gains are long-term if the capital asset is held for more than one year prior to the realization of gain or loss.
- **certain dividends and partnership distributions** – corporate dividends and partnership profit distributions (if taxed as a corporation) received by an individual from a Puerto Rico Entity, are subject to a 15% preferential tax.
- **interest on certain obligations or deposits with banking organizations** – interest from deposits in interest-bearing accounts or in certificates of deposits of individuals, estates, and trusts in banking institutions are subject to a 17% or 10% preferential tax, at the option of the taxpayer.

Tax rates for 2020

The ordinary tax rates for:

- individual taxpayers (including unmarried taxpayers, married taxpayers with prenuptial or postnuptial agreements with total separation of assets, and married individuals not living together);
- married individuals filing jointly; or
- married individuals filing separately, are:

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

Gradual adjustment

A 5% gradual adjustment (not to exceed \$8,895) of the lower tax rates, the personal exemptions and credit for dependents, applies to individual taxpayers with a net taxable income exceeding \$500,000.

For taxable years beginning after December 31, 2020, the tax determined is 92% of the sum of the regular tax and the gradual adjustment for individuals with gross income of \$100,000 or less. For individuals with gross income greater than \$100,000, the tax determined is 95% of the sum of the regular tax and the gradual adjustment.

Alternative basic tax (ABT)

The PR Tax Code provides for an ABT equivalent to the alternative minimum tax in the U.S. The ABT tax for tax years beginning after December 31, 2018, is:

Tax rate	Net taxable income subject to ABT
1%	if net taxable income is between \$25,000 – \$50,000
3%	if net taxable income is between \$50,000 – \$75,000
5%	if net taxable income is between \$75,000 – \$150,000
10%	if net taxable income is between \$150,000 – \$250,000
24%	if net taxable income is over \$250,000

The ABT includes most “exempt income” as income for ABT purposes (including income exempted by special statute). Limited exceptions include interest on obligations of the U.S. government, the Government, or any instrumentality or political subdivision thereof.

Optional tax

An optional tax is available for individuals whose gross income is substantially received from services subject to withholding at source. The tax rates are:

Tax rate	Gross income from services
6%	if gross income of \$100,000 or less
10%	if gross income is between \$100,000 – \$200,000
13%	if gross income is between \$200,000 – \$300,000
15%	if gross income is between \$300,000 – \$400,000
17%	if gross income is between \$400,000 – \$500,000
20%	if gross income is \$500,000 or over

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

- at least 80% of the total gross income for the taxable year is derived from the rendering of services subject to withholding at source; and
- the total gross income earned was subject to withholding at source or the payment of estimated taxes.

Nonresidents tax

A U.S. citizen that is not a resident of Puerto Rico, but receives income from sources within Puerto Rico, is required to file a Puerto Rico income tax return unless the total tax was withheld at source. When determining taxable income subject to Puerto Rico tax, a U.S. citizen not residing in Puerto Rico may only claim deductions that are properly allocable to such income.

In the case of a nonresident non-U.S. citizen, generally, is subject to a 29% Puerto Rico tax withholding at source on gross income from interest, royalties, salaries, wages, annuities, compensation, remuneration, emoluments, distributable share of income from a special partnership, net capital gains, and other fixed or determinable, annual, or periodic income from sources within Puerto Rico. Dividend income from sources within Puerto Rico is generally subject to a 15% income tax rate. The distributive share of income from a corporation of individuals is subject to a 33% income tax rate.

A nonresident non-U.S. citizen 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 the transaction would have been taxable. Moreover, if they are engaged in a trade or business in Puerto Rico at any time during the taxable year, they are subject to Puerto Rico tax at regular rates on their net income that is effectively connected to such trade or business in Puerto Rico.

When determining the net income of a nonresident non-U.S. citizen, deductions are allowed to the extent that they are effectively connected with the conduct of a trade or business in Puerto Rico. If the nonresident receives income from sources within Puerto Rico, they are required to file a Puerto Rico income tax return, unless the total tax was withheld at source.

Expatriates tax

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

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

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

Income from employment

In the case of a nonresident, the tax is assessed on employment income derived from services performed in Puerto Rico. Some exceptions may apply depending on the amount of income generated in Puerto Rico, and the time spent in the island. If the individual is considered a bona fide resident of Puerto Rico, all their income, no matter where earned or derived, is taxed in Puerto Rico.

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

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

Deductions against income

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

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

A nonresident non-U.S. citizen is allowed only deductions directly related to the income generated in Puerto Rico. They are not allowed any other deductions, personal or dependent exemptions.

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

Tax returns and compliance

Personal tax returns are due on or before April 15th following the end of the tax year. A 6-month automatic extension to file is available, extending the due date until October 15th. The extension must be accompanied by the full balance of the income tax due.

In the case of employees, even when the required income tax amount is withheld by the employer and deposited with the PR Treasury, the employee has the right to file an income tax return to claim applicable exemptions, deductions, and pay tax according to the applicable tax rate.

Individuals (residents and nonresidents) are required to file an income tax return when they have gross income unless the tax was fully paid by withholding at source.

Estimated tax

Every individual with a tax liability greater than \$1,000, is required to estimate its tax liability for the current taxable year. The estimated tax must be paid in four equal installments by:

- April 15th;
- June 15th;
- September 15th; and
- January 15th of the next taxable year.

Entities

Tax year

A tax year generally consists of a period of 12 months. An Entity may choose its tax accounting period on or before the due date for the filing of its first income tax return, without considering extensions. The PR Tax Code allows for:

- calendar year (i.e., 12/31);
- 12-month economic year; and
- 52 and 53-week year tax accounting periods.

Once a taxable year is chosen, that Entity must continue using it until the PR Treasury approves a change in accounting period (request from Entity is needed), or the law specifically permits otherwise.

Tax accounting methods

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

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

Federal tax

Entities organized under Puerto Rico law, are treated as foreign for federal income tax purposes. Thus, Puerto Rico Entities are subject to a 30% federal 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 U.S.

Dividends received by a Puerto Rico Entity from a U.S. Entity, however, and provided certain conditions are met, are subject to only a 15% federal income tax withholding instead of the 30% rate applicable to other foreign Entities.

Puerto Rico Entities are subject to regular federal income tax rates on the income that is effectively connected to a trade or business in the U.S.

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

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

Puerto Rico tax

Entities, domestic or foreign, taxed as corporations and engaged in trade or business in Puerto Rico, are subject to an income tax rate composed of two parts a:

- “normal” tax; and
- “surtax.”

(together known as the “regular tax”).

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

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

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

To determine the surtax rate applicable to Entities within a controlled group of corporations or group of related entities, as the case may be, the combined net income of all the Entities in Puerto Rico is considered.

If the Entity is a member of a controlled group of corporations or a group of related entities, as the case may be, the \$25,000 deduction to the net taxable income must be distributed among the members of the controlled group.

Alternative minimum tax (AMT)

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

The AMT equals the excess of the amount of the tentative minimum tax over the amount of the normal tax plus surtax. The tentative minimum tax is 30% of the excess of the net alternative minimum income over the exempt amount, reduced by the alternative minimum foreign tax credit for the taxable year. However, the AMT is the greater of \$500 or 18.5% of the alternative minimum net income.

Limitations are imposed regarding deductible expenses to determine the net income subject to AMT. Nevertheless, there is an option to claim all the ordinary and necessary expenses if the Entity submits AFS or an AUP, as the case may be, prepared by a CPA with license to practice in Puerto Rico.

Regarding amounts paid to related parties, the PR Tax Code limits the deduction of the expenses or charges incurred by an Entity with a related party that is not engaged in trade or business in Puerto Rico, if the expenses are not subject to Puerto Rico taxes. On this regard, the PR Tax Code provides that 51% of these expenses are not allowed as a deduction for ordinary tax computation. However, no adjustment or limitation is allowed if a Transfer Pricing Study is submitted with the income tax return, pursuant to the rules and regulations of the US Tax Code.

Optional tax

An optional tax is available for Entities whose gross income is substantially received from services subject to withholding at source. The tax rates are:

Tax rate	Gross income from services
6%	if gross income of \$100,000 or less
10%	if gross income is between \$100,000 – \$200,000
13%	if gross income is between \$200,000 – \$300,000
15%	if gross income is between \$300,000 – \$400,000
17%	if gross income is between \$400,000 – \$500,000
20%	if gross income is \$500,000 or over

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

- at least 80% of the total gross income for the taxable year is derived from the rendering of services subject to withholding at source; and
- the total gross income earned was subject to withholding at source or the payment of estimated taxes.

Tax returns and compliance

Generally, Entities engaged in trade or business in Puerto Rico, are required to file an annual income tax return and pay the corresponding tax on or before the 15th day of the 4th month following the close of its taxable year.

In the case of **Entities with a pass-through tax treatment**, the income tax return is due on or before the 15th day of the 3rd month following the close of its taxable year.

In the case of **Entities with a corporation tax treatment**, who hold a Decree of Tax Exemption from the Government (i.e., Act 20), the income tax return is due on or before the 15th day of the 6th month following the close of its taxable year.

An automatic 6-month extension of time is available for the filing of the income tax return if filed on or before the due date of the income tax return. The extension must be accompanied by the full balance of the income tax due.

Every Entity whose volume of business is equal to or more than \$10,000,000 must attach AFS to their income tax return.

In the case of a controlled group of corporations or group of related entities, as the case may be, they must submit AFS financial statements for every Entity within the group with a volume of business of \$1,000,000 or more if the aggregate volume of the group is \$10,000,000 or more.

Act No. 163 of 2014, requires the presentation of supplementary information along with the AFS that will accompany the income tax return.

The supplementary information is required to be subject to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling the information directly to the underlying accounting and other records used to prepare the financial statements.

Estimated tax

Every Entity engaged in trade or business in Puerto Rico is required to estimate its tax liability for the current taxable year. The estimated tax must be paid in four equal installments by the 15th day of the 4th, 6th, 9th, and 12th month of the taxable year.

Consolidated returns

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

Use of net operating losses (NOL)

For purposes of determining the amount of the carryover, NOL 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 NOL deduction carry forward from previous years is not deducted. The carryover period depends 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 AMT** purposes. For taxable years beginning **after December 31, 2018**, the NOL carryforward amount is increased to **90% of net income** for regular tax purposes and at **70% for AMT** purposes.

Foreign tax credit (FTC)

To mitigate or eliminate the risk of double taxation of the same income, Puerto Rico Entities have the option of either deducting or crediting the income and excess profit taxes paid or accrued during the taxable year to the U.S., any of its possessions, or any foreign country.

However, a Puerto Rico Entity 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 FTC is allowed to reduce the accumulated earnings penalty tax.

The amount of FTC is subject to the per-country limitation and the overall limitation. The excess of foreign taxes paid or accrued by the Puerto Rico Entity over the FTC 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 Entity may be deemed to have paid the foreign income and excess profits tax allocable to the distributed earnings received from its foreign subsidiary.

Dividends

A Puerto Rico Entity's dividend distributions are subject to a 15% withholding tax upon distribution.

An accumulated earnings penalty tax of 50% may be imposed if an Entity 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 the 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 Decree of Tax Exemption issued pursuant to Act No. 60 of 2019, known as the Incentives Code of Puerto Rico, or any prior incentive tax laws of similar nature, are not considered.

Services

A 10% withholding at source applies to payments made in the conduct of a trade or business or for the production of income in excess of \$500 to any Person for services performed within Puerto Rico. Some Persons may get a total or partial waiver from the withholding. The partial waiver reduces the withholding tax to 6%, if the Person is in good standing with the PR Treasury.

Fixed and determinable annual or periodic income

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

Type of withholding	Tax rate
Resident individuals:	
• interest from deposits in banking institutions in Puerto Rico	10%
• interest on IRA accounts	17%
• dividends from rental of buildings in historic zones	15%
• dividends from bona fide farming	15%
• all other dividends from domestic Entities	15%
• capital assets income transactions	15%
Nonresident U.S. citizens:	
• general	20%
• dividends	15%
• distributable share from partnerships, LLCs taxed as partnerships, special partnerships, and corporation of individuals	30%
• interest from related and nonrelated persons	0%
• payments for sale of real property in Puerto Rico	15%
Foreign Entities not engaged in trade or business:	
• dividends	10%
• royalties	29%
• interest from unrelated persons	0%
• interest from related persons	29%
• distributable share of special partnerships	29%
• distributable share of partnerships, LLCs taxed as partnerships, and corporation of individuals	30%
• payments for sale of real property in Puerto Rico	29%
• all other fixed or determinable annual or periodical gains, profits, and income	29%

Other reporting requirements

Generally, contrary to the US Tax Code, an informative return (equivalent to 1099s), is filed for any payment of dividends, or any payments in excess of \$500 for interest, rent, salary, wage or service, premium, annuity, compensation, remuneration, or other fixed or determinable gain, profit, and income.

Any Person who credits or makes payments to another Person of \$500 or more, is required to withhold tax on the payments and file an informative return (i.e., 480s) specifying the total amount paid or credited, the tax deducted and withheld, the name, address and the account number of the Person to whom the payment or withholding was made.

The 480 is filed on or before February 28, of the year following the calendar year in which the payment was paid.

Municipal license tax (MLT)

The MLT, which operates based on the fiscal year of the Government (July 1 through June 30), is imposed on gross income. The tax rate varies depending on the municipality but ranges from 0.2% to 0.5% in the case of nonfinancial businesses, and from 1% to 1.50%, for a financial business. The tax is paid directly to the municipality.

A number of business activities and types of income are exempt from the MLT. For example:

- businesses operated by or for the Government;
- businesses with a volume of business of \$5,000 or less;
- income from the sale of agricultural products to farmers;
- tax-exempt or not-for-profit Entities;
- IBEs;
- insurance companies;
- the export 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 (PREPA); and
- plants engaged in the processing of tuna (provided they
- employ 300 or more individuals in the same physical facility).

The MLT annual return or volume of business declaration as it is known, is filed every year within five working days after April 15th. A 6-month extension to file is available.

The MLT may be paid in two equal installments, with the first installment payable on or before July 15th, while the second installment is due on or before January 15th. Nonetheless, if the total MLT is paid by the declaration's due date, a 5% discount is applied.

AFS certified by a CPA licensed in Puerto Rico must be attached to the declaration if the total volume of business is between \$3,000,000 and \$10,000,000, provided an AUP may be attached instead of the AFS if prepared by a CPA licensed in Puerto Rico. When the volume of business exceeds \$10,000,000, AFS are required. Otherwise, a copy of the income tax return is required to accompany the declaration.

After the first installment is paid or the full tax is paid with the filing, as the case may be, the municipality will issue a municipal license that must be posted in a clearly visible place in the business or service establishment.

Property tax

Municipalities may impose, by means of municipal ordinances, a property tax of:

- up to 10.33% per annum on the appraised value of all taxable personal property in the municipality, and
- up to 12.33% per annum on the appraised value of all taxable real property in the municipality.

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

Municipalities do not have jurisdiction to impose property taxes on property located outside Puerto Rico. In addition, property in interstate or foreign commerce is not subject to the Puerto Rico property tax. On the other hand, a property tax can 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 (PPT)

Any Person engaged in trade or business in Puerto Rico, and that as of January 1 owns personal property used in the trade or business, must pay PPT 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 Person. 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, inventory, 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 PPT return is filed on or before May 15 of each year in the corresponding regional office of the Municipal Revenue Collection Center or CRIM for its Spanish acronym, together with the full payment of the tax. A 3-month extension to file is available, although the tax must be paid by the due date.

AFS certified by a CPA licensed in Puerto Rico must be attached to the return if the total volume of business is between \$3,000,000 and \$10,000,000, provided an AUP may be attached instead of the AFS if prepared by a CPA licensed in Puerto Rico. When the volume of business exceeds \$10,000,000, AFS are required. The financial statements of foreign Entity engaged in business in Puerto Rico should reflect solely their operations in Puerto Rico.

In the event that the Entity does not have a calendar year closing, a trial balance of its business activities in Puerto Rico as of the preceding January 1 is 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 Person.

Real property tax (RPT)

The RPT is imposed on the value of the property as assessed by the CRIM. The tax is payable semi-annually on July 1 and January 1 of each year. The assessed value is the valuation of the property for RPT 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 PR Treasury or other agencies (i.e., alcoholic beverage, cigarettes, financial institutions and air, land and sea carriers, among others).

Sales and use tax (SUT)

Every Person engaged in any business that sells taxable items or provides taxable services is responsible to collect the SUT as a withholding agent. Nonetheless, service providers whose volume of business does not exceed the following thresholds are considered Non-Withholding Agents and therefore exempt from collecting both the 11.5% basic SUT (10.5% state portion plus 1% municipal portion) and the 4% special SUT:

- \$300,000 for services rendered to other merchants;
- \$200,000 for designated professional services; or
- \$50,000 for taxable services.

Rates

As a general rule, the regular SUT rate is 11.5%, and applies to:

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

Furthermore, a special SUT rate of 4%, applies to certain services rendered from October 1, 2015, onward. They are:

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

However, pursuant to the PR Tax Code, there are certain services rendered between merchants, known as taxable services, that are taxed at the 11.5% rate.

Beginning on October 1, 2019, a reduced regular SUT rate of 7% applies to eligible restaurants selling taxable items such as prepared foods, carbonated beverages, confectionary products and candies (excludes alcoholic beverages). To qualify, the business must comply with the following requirements:

- the certificate of merchant registration must have one of the following NAICS codes;
 - 72231 - Food Service Contractors
 - 72232 - Caterers
 - 72233 - Mobile Food Services
 - 72241 - Drinking Places (Alcoholic Beverages)
 - 72251 - Restaurants and Other Eating Places
- must be current with the filing of monthly SUT returns and declarations;
- the Person should not have any tax debts for any concept with the PR Treasury; and

- the Person must comply with the requirement to install, possess and maintain, at each point of sale in the commercial locations, a fiscal terminal despite the exception to the requirement for those Persons whose annual aggregate sales does not exceed \$125,000.

The PR Tax Code also provides several exclusions and exemptions from the SUT, which vary depending on the taxable item purchased or the Person who purchases the item.

Semi-monthly sales tax deposits

The PR Tax Code requires the following Persons to deposit the sales tax in semi-monthly installments:

- large taxpayers (as defined in the PR Tax Code); and
- merchants with monthly SUT deposits for the prior calendar year in excess of \$2,000.

For purposes of the \$2,000 criteria, the term “deposited” refers to the sum of the SUT deposited on the import and purchase of inventory for resale, and the SUT deposited on sales made by the merchant. The deadlines for making the semi-monthly deposits are:

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

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

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

Exemption certificates

Every registered merchant who is a reseller, may request a Certificate of Reseller and Municipal SUT Exemption through the Unified System of Internal Revenue or SURI (for its Spanish acronym).

To qualify, the registered merchant during the period of three taxable years immediately preceding the year for which it is wanted to determine whether the merchant is a reseller or not, an average of 80% or more of its inventory must have been removed for resale (not including the sales of services or the sale of exempt items).

This certificate will allow the reseller to claim a credit for the SUT paid upon purchases of tangible property for resale up

to 100% of the amount to be deposited with the SUT monthly return. Also, it allows its suppliers to collect only 10.5% on those purchases.

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

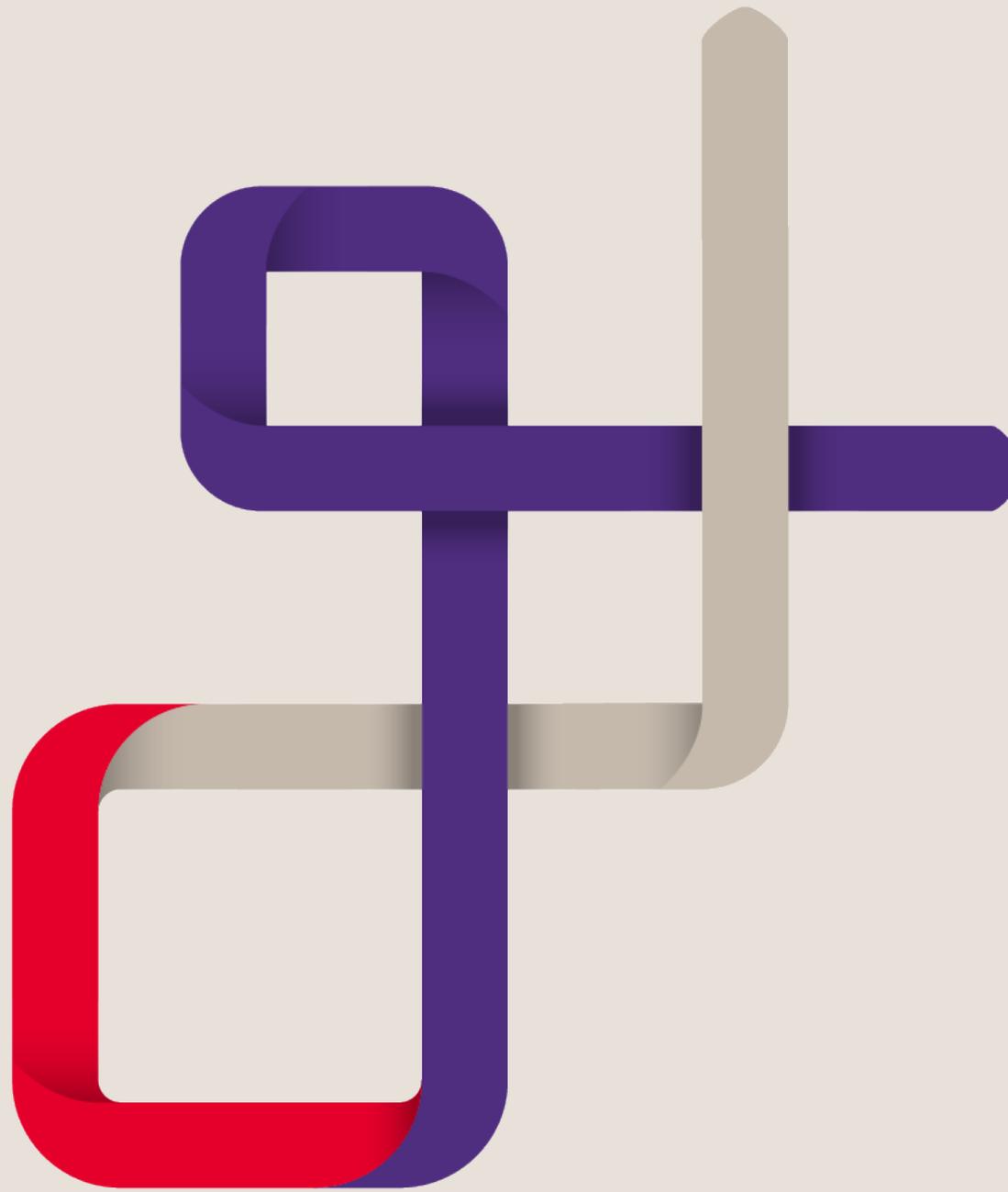
If substantially all sales are made to exempt Persons (i.e., Government, manufacturers, etc.) or for exportation, the reseller may request a Certificate of Eligible Reseller through SURI. This certificate will provide exemption to the reseller on the payment of SUT upon eligible purchases.

Gift tax

Effective January 1, 2018, no gift tax is imposed on property donated. Nevertheless, the donor is required to file a gift tax return 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. Furthermore, the basis of the property donated is the same basis the property had in the hands of the donor at the time such gift was made (no step-up).

Estate tax

Effective January 1, 2018, no estate tax is imposed on the estate of a decedent. Nevertheless, the administrator of the estate is required to file an estate tax return on or before 12 months after the decedent’s death. Furthermore, the tax basis of the inherited property is the same basis the property had in the hands of the decedent (no step-up).



Tax Incentives

Tax Incentives

Summary

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

Qualifying industries such as scientific research and development, manufacturing operations, export services, financial and insurance services, recycling businesses, technology, film, agriculture, hospital facilities, hotels and related tourist activities are eligible for full or partial exemption from income, property, municipal and other taxes.

The Puerto Rico Department of Economic Development and Commerce or DDEC for its Spanish acronym, is the primary government institution tasked with promoting industry and foreign direct investment in Puerto Rico.

Overview

Aiming to codify incentives granted for diverse purposes throughout decades in one code and foster economic development more effectively, Act 60 of 2019 (“Incentives Code”) establishes a Return on Investment (ROI) methodology as a measurement tool to grant tax incentive benefits.

Although the effective date of the Incentives Code is July 1, 2019, the Government established a transition period of 6 months, ending on December 31, 2019, allowing taxpayers to file for tax incentive benefits under prior tax incentives laws, provided they were not completely repealed by the Incentives Code. Therefore, starting on January 1, 2020, all tax incentives applications are submitted under the Incentives Code. For simplification purposes, we will focus the discussion of benefits under the Incentives Code. However, note that incentives granted under previous laws are subject to the provisions of the law under which the Decree of Tax Exemption (“Decree”) was issued.

The Incentives Code adopts a legal and administrative framework for the application, evaluation, and grant or denial of incentive benefits by the Government. The following are some standard terms and benefits provided by the Incentives Code to eligible and exempt businesses:

- 4% fixed income tax rate on eligible income;
- 75% exemption on property taxes;
- 50% exemption on municipal taxes;
- Decree period standardized to 15 years, with an extension of 15 additional years;

- eligible businesses with a Decree for export, with an annual projected or actual volume of business of more than \$3,000,000 must have at least one full-time employee; while those with a Decree for manufacturing, must have at least three full-time employees, and
- research and development tax credits.

Incentives

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

Tax benefits and incentives

Individuals (i.e., Resident individual investors, Professionals of difficult recruitment)

Exportation of goods or services

IFEs, International insurers and reinsurers, Public-private partnerships and Private equity funds

Tourism and Cruise-ship industry

Manufacturing

Infrastructure, including renewable energy

Agroindustrial activities

Film and creative industries

Entrepreneurship for young individuals

Foreign trade zones

Priority Projects for qualified opportunity zones (OZs)

** Special incentives are available for operations in the municipalities of Vieques and Culebra, small and medium businesses (PYMES), strategic projects and pioneer activities.*

Additional information

You can refer to our Puerto Rico Tax and Incentives Guide which includes more details when establishing a business in Puerto Rico.

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