RE BUILDING PUERTO RICO

Acts 20 & 22 Interplay With New U.S. Tax Reform

SPECIAL TO CARIBBEAN BUSINESS

Not long after the passage of hurricanes Irma and Maria, Puerto Rico is weathering another storm with the approval of the much-touted federal tax reform that was signed into law by President Trump Dec. 22, 2017.

"The Tax Cut & Jobs Act is without a doubt the most dramatic tax change in the United States since the enactment of the actual federal tax code in 1986," said Francisco Luis, tax partner at Kevane Grant Thornton. "Individuals and businesses in the United States will have new rules that include reduced tax rates, as well as less and different deductions, among other major changes."

Nonetheless, the new international tax rules of the federal tax system have alerted the international arena because of its magnitude.

"We saw the intent to migrate from the traditional worldwide tax regime of the federal tax system to a semi-territorial regime, at least as it relates to foreign subsidiaries owned by corporations in the United States by the expansion of the 'dividend-received-deduction,'" Luis said. This allows the parent company in the United States, he added, to receive tax-free dividends from their foreign subsidiaries (there is a transition tax to convert to this semi-territorial tax regime).

However, there are new players in the federal tax law, the so-called GILTI and the BEAT. The GILTI (the acronym for Global Intangible Low-Taxed Income) in summary inserts a new complex formula to tax intangibles in foreign jurisdictions that are highly profitable with low taxation. For its part, the BEAT (the acronym for Base Erosion Anti-Abuse Tax) is a new tax to be imposed on United States taxpayers when transacting with related entities in the foreign arena.

Long before its enactment, political campaigns in the mainland U.S. had anticipated these new federal

Francisco Luis, tax partner at Kevane Grant

rules in the international tax arena. Considering these reports, Puerto Rico's public and private sectors engaged intensively in continuous lobbying efforts to insert some preferential treatment for Puerto Rico, in comparison with the rest of the world. Though these efforts were unsuccessful, the truth of the matter is that Puerto Rico boasts a series of tax incentives that make it a prime location for careful tax planning.

Specifically, both Acts 20 and 22 provide a series of advantages to the above-mentioned international taxes since the key factor for their imposition is the presence of related entities in the United States and the foreign jurisdiction.

Acts 20 and 22 are focused on bringing new residents to Puerto Rico and transforming Puerto Rico into a service center hub. Our island still offers the interesting combo, where individuals are born United States citizens and the entities created in Puerto Rico are considered foreign for U.S. tax purposes. The U.S. tax reform did not change this. The U.S. Tax Code still maintains an exclusion from federal taxation for those that are Puerto Rico bona fide residents regarding the income that is from sources within Puerto Rico. One of the main attributes of Act 22 is the 100% exemption on capital gains (in addition to the exemption on interest and dividend income) that has brought more than 1,000 new residents to Puerto Rico. Such advantages are still valid.

Puerto Rico can still be an important option because of its political relation with the United States, currency and banking system.