

# Tax Alert: A federal tax incentives proposal for Puerto Rico's economic growth

**The Puerto Rico Manufactures Association (PRMA) recently presented to the US Congress a proposal to provide federal tax incentives for US entities operating in the island in an effort to promote the economic growth of Puerto Rico. We may see public discussion on the topic shortly and if the upcoming federal oversight board created by the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), endorses the proposal, it may support the required lobby efforts in the US Congress. We hereby provide a general framework of the proposal.**

In essence, the proposal provides preferential tax rates for the repatriation of dividends from US owned subsidiaries in Puerto Rico. In addition, it offers incentives for the local investment in research and development, property, plant and equipment.

The main industry of focus is the manufacturing sector that suffered a significant negative impact when the US IRC Section 936 was eliminated in a ten year transition period that ended in 2006.

The PRMA sustains that if the proposal is adopted it could result in the creation of 50,000 additional direct employment opportunities for Puerto Rico.

The proposal presented by the PRMA has four main components. First, it provides for a

federal tax exemption of up to 85% of the dividends that are repatriated from Puerto Rico operations to the US. This would grant the Puerto Rico corporations, which are currently considered as foreign corporations under the federal tax code, a treatment similar to the US domestic corporations that have the mechanism of the “dividend-received-deduction” under US IRC Section 243.



The second component of the proposal is a 50% reduction on the applicable tax rate for the remaining 15% of the dividend that would be taxable. Since these dividends are normally taxed at the rate of 35%, such rate would be reduced to 17.5%. Provided that the reduced tax rate would only apply to 15% of the dividend, the overall effective tax rate of the dividend would be less than 3%.



## Contact us

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The third and fourth components of the proposal relate to the passive income of the Puerto Rico corporation. Such passive income would be exempt for federal tax purposes up to the amount that represents 25% of the investment made on research and development. However, the passive income that doesn't qualify for the DRD could be maintained in Puerto Rico and federal taxation will be deferred up to five years.

If the proposal is approved, it will be important to evaluate the interplay with the Puerto Rico local tax incentives like for example Act 73 of May 28, 2008, known as the Economic Incentives Act for the Development of Puerto Rico and Act 20 of January 17, 2012, known as the Act to Promote the Export of Services, which could provide substantial tax savings for the US owners.

We will monitor the development of this proposal and keep you updated with our Alerts.

**Please contact our Tax Department should you require additional information regarding this or any other tax issue. We will be glad to assist you.**