



Tax



Incentives



Taxpayer

# Puerto Rico tax incentives- interplay with the federal tax laws

September 2017 wrote one of the most, if not the most, dramatic and important chapters in Puerto Rico's modern history. The widespread destruction caused by hurricanes Irma and Maria negatively impacted an already-beleaguered economy that was mired in an 11-year recessionary period. However, almost paradoxically, these catastrophic events could very well represent a positive and significant turning point in the path to economic recovery that the island desperately needs.

A main component of the financial forecast of the 2018 Puerto Rico government fiscal plan – and a significant change from the 2017 fiscal plan – is the disaster relief assistance expected in the coming years that will help rebuild the infrastructure as well as provide the foundation for economic renewal. Prior to the hurricanes, since Puerto Rico's public infrastructure was in a crisis and with no access to credit markets it was quite difficult to foresee a renovation. However, the aforementioned influx of relief capital cannot lift the economy by itself. Adequate investment conditions must be provided to ensure continuous growth and the creation of new capital by both local and foreign investors. That is where Puerto Rico tax incentives come into play. Historically, Puerto Rico has used tax incentives as a tool to assist in the economic development of the island. This is how Puerto Rico transformed from an agricultural economy to an industrial one in the 1940's and, as of late, to a finance and service industry with incentives acts for exportation of services, as well as international insurance and banking. And when the many changes in the international economic arena are taking into consideration, one would be hard-pressed to refute that these incentives are and will continue to be a necessary component for the Puerto Rico recuperation.

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Take for example the much-touted federal tax reform that was signed into law by President Trump on December 22, 2017. The Tax Cut and Jobs Act is without doubts the most dramatic tax change in the United States since the enactment of the actual federal tax code in 1986. Individuals and businesses in the United States now 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 stirred the international scenario because of their 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”, allowing the parent company in the United States 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 (which stands 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.

Conscious of these impending changes, Puerto Rico’s public and private sectors engaged intensively in continuous lobby 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. On this regard, we can certainly assert that industries like manufacturing, construction, tourism, export and financial services provide a series of advantages to the above-mentioned international taxes since the key factor for the imposition of these is the presence of related entities in the United States and the foreign jurisdiction.

Acts 20 and 22, for example, are focused on bringing new residents to Puerto Rico and transforming Puerto Rico into a service center hub by providing from 100% exemption to a 4% flat tax on net income earned from export activities. Act 73 provides similar incentives to those under Act 20 but focused on manufacturing with a broad eligibility that includes industrial commercial scale activities, housing construction, and recycling, among others. The tourism sector continues enjoying incentives that go from 90% income tax exemption to tax credits for investments made into the projects. On top of this, Puerto Rico still offers the interesting combo where born individuals are United States citizens and the entities created in Puerto Rico are considered foreign for US tax purposes. Exclusions in the US tax law, allow Puerto Rico residents to be exempt from federal taxation on their income earned in Puerto Rico. The US Tax reform did not change this. However, we must not underestimate the crucial role of monitoring the interplay of the Puerto Rico tax incentives with the new US tax considerations, mostly when we have structures that include US Shareholders.

While both the hurricanes and the approval of the US Tax Reform could arguably spell adverse consequences to the island, **Puerto Rico is in an excellent position to turn these into favorable outcomes and come stronger than ever before.**

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



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