



Audit



Tax



Advisory



Outsourcing

Puerto Rico tax and incentives guide 2021

If you are planning on doing business in Puerto Rico, information on the tax framework and updates on tax incentives are essential to keep you on the right track.

Business guide



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Foreword

Foreword

Over the past years, it has become increasingly important for us to keep the business community and prospective clients informed about the benefits of establishing, relocating or expanding businesses in Puerto Rico. Puerto Rico offers the security and stability of operating in a United States jurisdiction with an array of special tax incentives for foreign direct investment that can be found nowhere else in the world.

Puerto Rico offers tax incentives packages which can prove to be attractive to individuals and businesses from the United States of America (“U.S.”), and other foreign countries. These include:

- a fixed corporate income tax rate, one of the lowest in comparison with any U.S. jurisdiction,
- various tax exemptions and special deductions,
- training expense reimbursements and
- preferential tax treatment for pioneer activities.

Labor and tax laws and our outstanding infrastructure provide the opportunities and benefits of doing business on the island. Our skilled and highly educated workforce attracts industries as diverse as:

- pharmaceuticals;
- biologics;
- medical devices;
- aviation and aerospace;
- information technology;
- renewable energy; and
- specialized manufacturing.

At Kevane Grant Thornton, we have gathered all relevant information to summarize the tax system and incentives of the island, to those interested in doing business in Puerto Rico.

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

Additional information

You can refer to our Doing Business publication which includes more details when establishing a business in Puerto Rico.



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Kevane Grant Thornton

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Our clients

We focus on dynamic organizations, companies with ambition and growth plans, just like us. These dynamic organizations vary from small proprietorships, to middle-market and listed companies. We have significant experience in serving a wide variety of business activities, including: banking sector, consumer products and retail/wholesale, financial services, healthcare, industrial products, technology, media and telecommunications, not-for-profit, property, casualty and life insurance, public sector, real estate, and construction, services, and travel, tourism and leisure. Additionally, we prepare individual income tax returns- Puerto Rico, U.S., and state returns- for a large group of individual clients.

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About Puerto Rico

About Puerto Rico

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 United States, located in the northeastern Caribbean, east of the Dominican Republic and west of both, the United States Virgin Islands and the British Virgin Islands.

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 Commonwealth’s executive departments. There are two legislative chambers: the House of Representatives and the Senate.

The judicial system is comprised by four main bodies: the Supreme Court, the Court of Appeals, the Court of First Instance and a lower-level system of municipal courts throughout the island.

Puerto Rico has authority over its internal affairs unless 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.

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. Spanish is the dominant language of education and daily life on the island, spoken by over 95% of the population. Public school instruction in Puerto Rico is conducted entirely in Spanish. All federal matters are conducted in English.



Population

According to the 2020 U.S. Census of Puerto Rico the revised population estimate is approximately 3.2 million people. When compared to the 2010 Census, Puerto Rico has experienced a decrease in population, mainly due to a reduction in births, an increase in death rates and migration to the United States mainland.

Labor force

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



Establishing a business in Puerto Rico

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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 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 Puerto Rico Department of Treasury (“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, natural or juridical ("Person"), 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 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)

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:
 - o rents or royalties derived from the use outside Puerto Rico of intangibles such as secret processes, formula, patents, trademarks, franchises, and copyrights;
 - o 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;
 - o 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.





Puerto Rico tax system

Puerto Rico tax system

The Puerto Rico 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.

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:

Tax 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.

Alternate 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 income	Percentage of exemption
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 distributable 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 such a 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 they receive 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.

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 method

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.

Sole proprietorships

A sole proprietorship is taxed on the net income from the operation of its trade or business. The net income, generally, is determined using the rules discussed below for corporations.

However, the PR Tax Code establishes a series of exceptions, such as the treatment of the net operating losses. Specifically, net operating losses incurred by a business operated by an individual as a sole proprietorship may not be used to reduce the net income derived from other business activities conducted by the same individual. However, if married individuals filing jointly, each owning a different principal trade or business, both principal trades and businesses are treated as one principal trade or business for purposes of the net operating loss deduction.

Partnerships

Upon the enactment of the PR Tax Code in 2011, partnerships and joint ventures, among others, are now provided pass-through tax treatment for income tax purposes. The tax treatment of partnerships and their partners is similar, but not identical to the treatment under the US Tax Code.

Instead of being taxed at the partnership level, these Entities are taxed at the partner level. Partners' fiscal responsibility is based in their distributive share of the partnership's income items, at their applicable rate, even though the income was not distributed. Moreover, partners are deemed engaged in trade or business in Puerto Rico with respect to their distributive share in the partnership.

Nonetheless, partnerships existing as of January 1, 2011, may elect to continue being taxed as a corporation. In such case, partnerships and their partners are subject to tax at the Entity level and again at the partner level to the extent the partnership makes any distributions.

Limited liability companies

LLCs are generally taxed as corporations, being subject to tax at the Entity and member levels. Nevertheless, LLCs may choose to be taxed as partnerships for income tax purposes, receiving pass-through tax treatment, thus being taxed at the member's level on the respective distributive share of the LLCs' income items.

Special partnerships

A partnership or a corporation that meets certain requirements may have elected to be treated as a special partnership for income tax purposes. This treatment allows for pass-through of income and losses to the owners of the Entity, eliminating the double taxation of income.

To qualify, at least 70% of the gross income must be derived from sources within Puerto Rico and 70% of the gross income must be from the performance of one or more of the qualifying activities discussed herein.

The special partnership election is not available for years commencing after December 31, 2010. Those elections made in prior years are still effective.

Corporations of individuals

Domestic corporations owned by 75 or less individuals may choose to be taxed as a corporation of individuals for income tax purposes if at least 90% of the gross income is derived from an active trade or business in Puerto Rico (certain activities do not qualify). The term domestic corporation includes for these purposes, a U.S. Entity solely engaged in a trade or business in Puerto Rico.

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

Corporations

For income tax purposes, corporations (including Entities taxed as corporations), are treated the same; there is no pass-through of income or losses to the shareholders, instead, taxes are levied at the Entity level and again at the shareholder level when actual distributions are made.

Before the enactment of the PR Tax Code, partnerships were taxed as corporations. Therefore, any reference to corporations in this section may also include the partnerships taxed as such.

A domestic corporation (i.e., one organized under Puerto Rico law) is taxed on its worldwide income. If tax is paid to a foreign jurisdiction, a foreign tax credit or deduction may be claimed, subject to certain limitations.

Puerto Rico corporations are taxed on their total net taxable income derived from any source whatsoever. Basically, the tax is determined by:

- excluding of certain items from gross income;
- excluding the items of income that are taxed at a different or preferential rate;
- reducing the remaining amount by the corresponding deductions;
- applying the preferential tax rates to the preferential tax rate items to determine the tax on preferential items;
- adding the partial tax to the tax on preferential items to determine the total corporate income tax; and
- reducing the total corporate income tax by estimated taxes paid, withheld amounts, and other credits.

The result is the amount of Puerto Rico corporate income tax due.

Corporations, domestic or foreign, 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”).

Normal 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%.

Surtax

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 audited financial statements (“AFS”) or an agreed upon procedures (“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 such 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, Entities 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.

Certain rules for foreign Persons

Source of income rule

Certain nonresident foreign Persons are treated as engaged in trade or business in Puerto Rico and deriving income from Puerto Rico sources for income tax purposes.

An office or a fixed place of business of a Person related to the nonresident may be treated as the office or fixed place of business of the nonresident Person, being treated thereby as engaged in trade business in Puerto Rico.

A Puerto Rico office of a related Person is treated as an office or fixed place of business of the nonresident in Puerto Rico when:

- such related Person had the authority to negotiate and contract in the name of the foreign Person and regularly exercised that authority or maintained an inventory of merchandise from which orders in the name of the foreign Person were regularly filled; and
- such foreign Person purchases goods from a related Person (more than 50% ownership) that manufactures, in whole or in part, personal property or performs services for or on behalf of, such nonresident Person in Puerto Rico, which for the taxable year or for any of the three preceding taxable years, subject to certain limitations.

The portion of the gains, profits, and income of the foreign Person purchaser that is treated as Puerto Rico source income, when the above requirements are satisfied, is determined by multiplying the total income of the purchaser by a fraction, the numerator of which is the sum of four equal factors: property, payroll, sales and purchases, and the denominator of which is four.

Excise tax

Notwithstanding the abovementioned, in lieu of taxation of the income of a nonresident Person meeting the 10% source of income tests, an excise tax is imposed on such nonresident Person that acquires personal property and services from related sellers whose gross receipts exceed \$75,000,000 for any of the three preceding taxable years.

The excise tax rate is 4% for purchases made during the calendar year 2011, with succeeding reductions to 3.75%, 2.75%, 2.5%, 2.25%, and 1% in subsequent calendar years. For calendar year 2017, the excise tax will no longer be in effect, being subject to the source of income rule thereafter. Nevertheless, the rate in effect has remained at 4% for all years until further assessment is made.

Certain credits are available for controlled groups to reduce the excise tax. Moreover, the excise tax paid may be claimed as an FTC for federal income tax purposes.

The tax is imposed on the Person acquiring the personal property and services but collected by the seller of the property or services and deposited with the PR Treasury by electronic means on or before the 15th day of the month following the month in which the purchase occurs with the corresponding payment voucher.

Each collector of the excise tax is required to file, for each quarter of a calendar year, a quarterly tax return on April 30, July 31, October 31, and January 31, and pay with the return that part of the tax that has not been paid or deposited with the monthly payment voucher.

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.

Financial reporting and audit

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.

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 is required 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 return when the volume of business is \$3,000,000 or more.

If Person has a volume of business over \$1,000,000, it may opt to submit AFS to request a Withholding Waiver Certificate. They 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. They 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.

Inventory

The method of inventory used for tax purposes must conform to the best accounting practices in the corresponding trade or business.

The term “best accounting practices,” as used in the PR Tax Code, are generally the same as “generally accepted accounting principles” (“GAAP”). In certain cases, however, GAAP may conflict with the clear reflection of income requirement; if such conflict occurs, the clear reflection of income should prevail. The most common methods that may be used to identify inventory are:

- specific identification method;
- first-in, first-out method (FIFO);
- last-in, first-out method (LIFO); and
- weighted-average cost method.

Pursuant to the PR Tax Code, inventory must be valued at the lower of cost or market value. The current regulations offer a number of rules regarding the use of the accounting methods and the valuation of inventory of certain industries such as securities, farming, livestock breeding, mining and manufacturing, and retailing.

Reserve method

The reserve method for deductions of bad debts is not allowed under the PR Tax Code.

Gross income

The meaning of gross income is broad and general. The PR Tax Code provides that gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal services, interest, rent, dividends, benefits from debt forgiveness, partnership profits, securities, or the transaction of any business carried on for gain or profit, or gains or profit and income derived from any source whatsoever.

By the same token, the PR Tax Code includes several exemptions and exclusions from gross income. Some are:

- interest from obligations issued by the U.S. and any of its states, territories, possessions, Puerto Rico, or political subdivisions thereof; and
- dividends from industrial development income that consists of interest derived from obligations of the Government or its instrumentalities or political subdivisions.

Capital gains

Under the PR Tax Code, Corporations may choose to have gains that are derived from the sale or exchange of a capital asset:

- taxed at a preferential income tax rate and have their other income taxed in the regular manner, or
- included as part of their gross income and taxed at the corresponding ordinary income tax rate.

If the first method is chosen, all long-term capital gains and losses are excluded from the gross income that is taxed at the regular tax rates. The alternate capital gains tax rate for corporations is 20%. A capital gain or loss is long-term if the capital asset was held by the transferor for more than one year prior to the transfer.

Notwithstanding the above, the following do not qualify as capital assets:

- stock in trade of the taxpayer or other inventory-type property and property held primarily for sale to customers in the ordinary course of a trade or business;
- property used in a trade or business entitled to depreciation and real property used in a trade or business;
- copyrights to literary property, musical, or artistic composition, a letter or memorandum or similar property in the hands of the creator or the transferee that takes the basis of the creator; and
- accounts payable or promissory notes acquired in the ordinary course of business.

There are several other situations in which the requirement of a sale or exchange for capital gain treatment is missing, but a capital gain or loss nevertheless will result because a statute creates a deemed sale or exchange or a deemed capital gain or loss. Examples of those situations are:

- securities becoming worthless;
- retirement of bonds and other securities issued by corporations, partnerships, a government and political subdivisions thereof, with interest coupons or in registered form;
- gains or losses attributable to the failure to exercise privileges or options to buy or sell property;
- distributions in excess of earnings and profits and of the basis of the stock; and
- distributions in liquidations or in partial liquidations.

Nonrecognition transactions

There are certain transactions in which a realized gain is not recognized for income tax purposes and, therefore, is excluded from gross income.

In general, the reason for not recognizing such gains is that the underlying transaction is not considered sufficient to break the continuity of the investment. Examples of these transactions are tax-free reorganizations.

Source of income rules

Personal services

Compensation paid for personal services performed in Puerto Rico.

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 a 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.

Interest income

The source of interest income is generally determined by reference to the residence of the debtor. The PR Tax Code grants preferential tax treatment to certain types of interest, such as interest on government bonds and interest on deposits in Puerto Rico financial institutions.

Dividend income

A Puerto Rico 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.

Rents and royalties

Income from rents and royalties paid with respect to property located in Puerto Rico, and rents and royalties paid for the use of, or for the privilege of using, within Puerto Rico, intangible assets such as patents, copyrights, trade secrets, formulas, goodwill, trademarks, trade names, and franchises, are treated as derived from sources within Puerto Rico.

Payments made for the right to transmit, within Puerto Rico, television and radio programs, films, and other similar property, are treated as income from sources within Puerto Rico.

Sale of real property

Gain from the sale of real property is sourced where the real property is located.

Sale of personal property

The source of income from the sale of personal property is determined by the seller's residence.

Sale of inventory

Gain from the sale of inventory property produced, in whole or part, by the taxpayer within Puerto Rico and sold outside Puerto Rico or produced, in whole or in part, by the taxpayer outside Puerto Rico is treated as derived partly from sources within and partly from sources without Puerto Rico.

Gains derived from the sale within Puerto Rico of personal property purchased by the taxpayer outside Puerto Rico and from the sale of personal property purchased within Puerto

Rico by the taxpayer and sold outside Puerto Rico is treated as derived entirely from sources within the country in which it was sold.

If the personal property is produced and sold in Puerto Rico, the income from the sale is sourced in Puerto Rico.

Distribution from liquidation of a Puerto Rico Entity

Income derived from the total or partial liquidation of a Puerto Rico Entity is treated as derived from sources within Puerto Rico.

Distribution from the liquidation of a foreign Entity

Income derived from the partial or complete liquidation of a foreign Entity is treated as derived from sources within Puerto Rico, if 80% or more of the Entity's gross income for the three years preceding the liquidating distribution was effectively connected with the conduct of a trade or business in Puerto Rico. However, the income is treated as from sources within Puerto Rico only in an amount that bears the same ratio to the total amount of the liquidating distribution as the gross income of the Entity effectively connected to the trade or business in Puerto Rico (excluding income considered in determining the branch profit tax, if applicable) bears to gross income from all sources.

Insurance premiums

Premiums paid with respect to a contract insuring risks located in Puerto Rico are treated as income derived from sources within Puerto Rico.

However, premiums paid on life insurance contracts to a Person not engaged in trade or business in Puerto Rico is not treated as income derived from sources within Puerto Rico.

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.

Expenses for income tax purposes

In general, the rules for the deductibility of the business expenses of a Person closely follow the applicable rules under the US Tax Code. Therefore, expenses incurred by a Person during the taxable year that are directly connected to its business activities are generally deductible.

Nevertheless, there are certain items which are statutorily nondeductible even though they would otherwise qualify as a business expense.

Organizational expenses

Organizational expenses are deductible only when the Entity is dissolved. When an Entity charter or certificate is issued for a limited time only, the expenses can be amortized over that period. These nondeductible expenses are generally incidental to the creation of the Entity, such as:

- legal fees for drafting the Entity's charter, bylaws, minutes of organizational meetings, and original stock certificates;
- fees for start-up accounting services;
- expenses of temporary directors and organizational meetings of directors or stockholders;
- operating agreements, and
- state incorporating fees.



Organizational expenses also relate to those incurred for issuing or selling shares of stock or other securities, such as commissions, professional fees, and printing costs, as well as to the transfer of assets to an Entity or the reorganization of an Entity.

Travel expenses

An employer may deduct the paid or reimbursed travel expenses incurred by its employees while working away from home, provided such expenses are ordinary, necessary, and reasonable. These expenses generally include transportation, meals, and lodging expenses for business-related travel. Travel expenses claimed as a deduction are limited to 50% of the travel expenses paid or incurred during the year.

Meal and entertainment expenses

Meals and entertainment expenses are subject to 25% limitation rule, in addition to being limited by the requirements of these being ordinary, necessary and reasonable. The 25% limitation rule provides that only 25% of the total of such expenses are allowed as a deduction, never to exceed 25% of the gross income of the Person taking the deduction.

Interest

As a general rule, interests are only deductible if the Person has an obligation to pay the interest and if it is an ordinary and necessary expense. However, interest related to an indebtedness incurred to purchase obligations which are exempt from Puerto Rico income taxes are nondeductible.

Royalties

Royalty payments are deductible within the category of ordinary and necessary expenses.

Retirement plan contributions

Basically, retirement plans can be divided into two types:

- qualified plans and
- nonqualified plans.

Qualified plans are those specifically covered by the PR Tax Code. These plans offer a special tax treatment to the:

- employer, who is allowed to deduct contributions made to the plan;

- participants, who can defer the employer's contributions until they are actually received; and
- the trust that controls and administers contributions to the plan and payments of benefits to the participants, which is treated as a tax-exempt entity.

Qualified plans are heavily regulated and are subject to strict reporting requirements.

Taxes

Taxes paid or accrued by an Entity are deductible unless otherwise prescribed by the PR Tax Code.

Puerto Rico income tax and all inheritance, estate, succession, and gift taxes are specifically listed as nondeductible.

Income taxes, war-profit taxes, and excess-profit taxes not imposed by Puerto Rico (i.e., imposed by the U.S. or any of its possessions, or by a foreign government) are deductible, but only if they are not otherwise claimed as a credit.

Federal import duties and Puerto Rico excise taxes on manufactured and imported goods are nondeductible (these charges are included as part of the costs of the goods). However, such taxes may be deductible if they qualify as necessary and ordinary business expenses. In such case, they would be deductible as a business expense and not as a tax and would therefore be required to meet the ordinary and necessary test.

Automobile license fees are considered a tax. As such, they do not need to meet the "ordinary and necessary" test.

Depreciation and depletion

The cost of business assets with a useful life of more than one year may not be deducted in full in the year of acquisition because part of the cost relates to future years. This deduction is generally referred to as depreciation. Inventory and stock in trade are not depreciable property.

The three depreciation systems that may be used under the PR Tax Code are:

- straight-line depreciation;
- accelerated cost recovery system (ACRS); and
- flexible depreciation as applicable to those assets for which an election was made. **No new elections are allowed by the PR Tax Code.**

Obsolescence

Generally, obsolescence is considered when determining the useful life of property. A special deduction for extraordinary obsolescence is allowed when the economic life of the property ends prior to the termination of its normal useful life.

Charitable contributions

Entities may deduct charitable contributions made within the taxable year to religious, charitable, scientific, literary, or educational organizations. The amount of charitable contributions made during a year may not exceed 10% of the net income, computed without the benefit of the charitable deduction.

Charitable contributions made in excess of 10% of net income may be carried over to the following five years.

Capital losses

For taxable years ending before January 1, 2015, corporations and partnerships are allowed to deduct capital losses of up to 90% of the gains from such sale or exchange. For taxable years beginning after December 31, 2014, the limitation is further reduced to 80%. For taxable years starting after December 31, 2018, the limitation is reestablished to 90%.

The carryover period for capital losses incurred is seven years.

Casualty losses

Casualty losses sustained by an Entity and not compensated for by insurance or otherwise are deductible. The basis for determining the amount of the loss sustained is the adjusted basis of the lost property.

Bad debts

Entities are entitled to an ordinary deduction for business debts that become worthless, or for the part of such debts that become worthless, during the taxable year. To allow the deduction for a bad debt, the Entity must have included the amount of such debt as income.

Worthless bonds/stock, similar obligations and right to acquire stock

If bonds, debentures, notes, certificates of debt, and other similar evidence of indebtedness become worthless during the year, the loss is considered due to the sale or exchange of a capital asset on the last day of the taxable year. In that instance, the Entity holding the worthless securities has a long-term or short-term capital loss depending on the length of the period during which the security was held.

If the worthless security was held for more than one year, the loss is treated as a long-term capital loss; otherwise, it is treated as a short-term capital loss. Partial worthlessness and reduction in value due to market fluctuations are not deductible.

Inventory write-downs

Goods in inventory that are unmarketable at normal prices or unusable because of damage, imperfections, shop wear, change of style, odd or broken lots, or other similar causes may be valued at their bona fide selling price less the direct cost of their disposition.

Rents

Rental payments made are generally considered part of the business expenses and, thus, deductible. Property taxes on leased property paid by the lessee pursuant to the terms of the lease are considered additional rent paid by the lessee. The amount of the property tax on the leased property paid by lessee is deductible by the lessor.

Salaries and wages

All reasonable salaries and wages, as well as commissions, bonuses, fees, compensation payments, and other similar payments made for services rendered paid are deductible.

Capital expenditures

The PR Tax Code follows the US Tax Code with respect to capital expenditures. The concept of capital expenditures is also based on the principle that the accounting method used must clearly reflect income.

Capital expenditures, instead of being deducted in the year in which they are paid or accrued, are included as part of the basis of the acquired or improved asset. In addition, depending on the asset and the circumstances involved, such capital expenditures will be depreciated, amortized, or depleted pursuant to the applicable depreciation, amortization, or depletion rules, or included as part of the basis until the asset is sold or disposed of.

Amounts paid for securing a copyright, defending or perfecting title to property, architect's services in relation to the construction of a building, and commissions in purchasing securities are capital expenditures.

Net operating loss (NOL) carryovers

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.

Nondeductible expenses

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 such 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. The limitation may be waived if the Entity files with the income tax return a Transfer Pricing Study prepared in accordance with Section 482 of the US Tax Code.

In addition, expenses incurred or paid for services rendered by a nonresident Person may not be deducted if the Entity has failed to pay the corresponding sales and use tax on said services. Likewise, the Entity may not deduct the cost or depreciation of any good or taxable item, if it fails to satisfy the sales and use tax on said item.

Tax credits

Foreign tax credit (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.

Gift tax

For gifts made after December 31, 2017, 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

Beginning on 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).

As a general rule, the estate of a decedent who is domiciled in Puerto Rico at the time of death, includes all the property of such decedent, wherever located. However, the estate of a nonresident who was a resident of Puerto Rico at the time of death but did not acquire the U.S. citizenship solely by reason of being a citizen of Puerto Rico or being born or residing in Puerto Rico, is only on the part of the estate located in Puerto Rico (same as any nonresident at death).

Upon the death of a decedent, an estate tax lien is automatically imposed on all the assets of the decedent. A Release of Estate Tax Lien will not be issued until the estate tax return is filed and all taxes owed by the decedent to the Government (including income taxes) or to its municipalities, have been fully paid. If the outstanding taxes are prescribed, a certificate to that effect must be obtained.

The executor of an estate is the person primarily liable for filing the estate tax return, and after filing, the executor may request the PR Treasury that they be released from personal liability with respect to the payment of deficiencies. If the PR Treasury does not reply to the request within one year after the date of filing the request, the executor is released from that liability.

Other reporting requirements

Generally, contrary to the US Tax Code, an informative return (equivalent to 1099s), is filed for any payment of dividends, 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 such 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 declarations, if the total volume of business is between \$3,000,000 and \$10,000,000, provided you may submit an AUP 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 may be 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 you may submit an AUP 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 merchant 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 merchant registration certificate 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 merchant should not have any tax debts for any concept with the PR Treasury; and
- the merchant 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 merchants 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.



10.5%

to the PR Treasury
and,



1%

to the municipality
where the business
is located.



Tax incentives

Tax incentives

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 of Puerto Rico 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 tax incentives

-
- Small and medium businesses (PYMES)

 - 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)
-

Small and medium businesses (PYMES)

PYMES (for its Spanish acronym) play a significant role in the economy of Puerto Rico and the Government is focused on facilitating their growth.

Under the Incentives Code, PYMES are defined as an eligible business with average gross receipts of \$3,000,000 or less during the previous three years and are subject to additional benefits during the first five years of operations. If an eligible business classifies as a PYME, it will enjoy the following incentives during the first five years of operations:

- 2% income tax rate on eligible income;
- 100% exemption on property taxes;
- 100% exemption on municipal taxes; and
- up to 30% tax credits on purchases of manufactured products in Puerto Rico.

Vieques and Culebra

An eligible business operating in the municipalities of Vieques and Culebra enjoy the following incentives during the first five years of operations:

- 2% income tax rate on eligible income;
- 100% exemption on property taxes;
- 100% exemption on municipal taxes; and
- up to 30% nontransferable tax credits on purchases of manufactured products in Puerto Rico.

Strategic projects

Companies promoted by the DDEC that execute projects deemed to have extraordinary importance for the economy of Puerto Rico (i.e., because they create and maintain a large number of jobs or a lesser number of high-quality jobs, promote new technology, transfer technology business knowledge, or are otherwise considered highly meritorious by the DDEC), may be eligible for specific additional incentives.

Pioneer activities

Means business activities not previously performed in Puerto Rico within a 12-month period by an eligible business filing an application for a Decree, and that possesses special attributes, characteristics or qualities for the socioeconomic development of Puerto Rico.

If an eligible business is designated as a pioneer activity, it enjoys a 4% fixed income tax rate on eligible income, that could be lowered down to 1%, at the discretion of the DDEC in consultation with the PR Treasury.

Individuals

Resident individual investors

Seeks to promote that nonresident individuals relocate to Puerto Rico as bona fide residents by providing a total exemption from Puerto Rico income tax on certain passive income realized or accrued after becoming a bona fide resident of the island.

The tax incentives apply to any individual that becomes a bona fide resident of Puerto Rico on or before the taxable year ending on December 31, 2035, and who was not a bona fide resident of Puerto Rico between January 17, 2006, and January 17, 2012.

Some of the tax incentives are:

- 100% exemption from income tax on certain passive income (i.e., interest, dividends).
- 100% exemption on all income from Puerto Rico sources pursuant to Section 933 of the US Tax Code (if individual complies with the bona fide resident tests).
- 5% income tax rate on capital gains from securities or other assets (i.e., cryptocurrency) owned that have appreciated in value prior to becoming a bona fide resident of Puerto Rico, and recognized 10 years after, but prior to January 1, 2036 (Special rules apply for federal income tax purposes).

- 100% exemption from income tax on the appreciation in value of the securities or other assets (i.e., cryptocurrency) after becoming a bona fide resident of Puerto Rico and realized before January 1, 2036.
- Decree expires on December 31, 2035.

As a condition for granting of the tax benefits, the Incentives Code requires that the individual:

- must provide evidence of a personal or commercial bank account in a financial institution or credit union with presence in Puerto Rico. If the individual has not moved to Puerto Rico, they may submit the evidence as soon as they reside in Puerto Rico.
- makes a \$10,000 annual contributions to a non-for-profit Entity authorized by the PR Treasury; provided \$5,000 of the donation made are destined to a non-for-profit Entity that works with the eradication of child poverty; and
- acquires residential real property by purchase from an unrelated Person within two years after the effectiveness of the Decree.

Qualified physicians

Seeks to promote that nonresident physicians relocate to Puerto Rico as bona fide residents and establish their practice in the island, while promoting to retain current physicians practicing in Puerto Rico.

Every individual admitted to the practice of general medicine or of any specialty, of podiatry, audiology, chiropractic, optometry, a dental surgeon or practices some specialty of odontology, and a medical doctor currently studying in a credited residence program, is considered a qualified physician and may request the tax benefits, subject to the limitations discussed below.

Qualified physicians are exempt from the required annual contributions of at least \$10,000 to not-for-profit Entities operating in Puerto Rico duly certified by the PR Treasury.

Some of the tax incentives are:

- 4% income tax rate on eligible income; and
- 100% exemption from income tax on distributions to shareholders, partners, or members, up to \$250,000 per taxable year.

Currently, no Decrees are being granted or approved.

Professionals of difficult recruitment

Although the term is yet to be further defined by the DDEC, the eligible individual must be a full-time employee whose specialized knowledge is indispensable to a business with a Decree. If the requirement is met, the individual is able to request a Decree for themselves.

Incentives include:

- 100% exemption from income tax on salaries derived in excess of \$100,000; provided the first \$100,000 of salaries earned are subject to the regular income tax rates stated in the PR Tax Code.

The individual is exempt from the required exempt from the required annual contributions of at least \$10,000 to not-for-profit Entities operating in Puerto Rico duly certified by the PR Treasury.

Researchers or scientists

An eligible researcher or scientist contracted by the University of Puerto Rico, or any other institution of superior education authorized to operate in Puerto Rico and engaged in eligible scientific research, subject to certain requirements and certifications, is eligible for a Decree providing an income tax exemption not to exceed \$195,000 of the salaries received.

Moreover, an eligible researcher or scientist contracted to provide scientific and technology research and development services within the district set forth on Act No. 214 of 2004, known as the Act to Create the Puerto Rico Science, Technology and Research Trust, is eligible for an income tax exemption not to exceed \$250,000 of salaries received.

An eligible researcher or scientist that requests a Decree under the provisions herein included, must render at least 60 hours of community service per year, pursuant to the requirements included in the Decree.

Senior individuals

Adopts a public policy to promote and develop the full potential of the senior population, through education and training, for them to reincorporate to the workforce or become entrepreneurs and contribute to the economic development of Puerto Rico.

Qualified promoters

Adopts incentives for qualified promoters that render promotions services to new businesses under a Decree. Promoters enjoy an incentive of up to 50% of the income tax paid by the exempt business that enters the Economic Incentives Fund and is transferred to Invest Puerto Rico Inc., for a period of up to 10 years since the date of establishment of the new business in Puerto Rico.

An individual may qualify for the incentives if they comply with the following requirements:

- be the owner, stockholder, member or employee full-time of an eligible business with a Decree for promotion services;
- possess a bachelor's degree from an accredited university;
- have at least five years of professional experience in their field;
- have the ability to understand and adequately express matters related to the establishment of new businesses in Puerto Rico; and
- file a sworn application with the DDEC, among other requirements.

The qualified promoter cannot claim the tax incentives for new businesses which they own or is a stockholder or member of, or their spouse, parents or children are in a managerial role involving decision making.

Export of goods and services

The tax incentives attempt to turn Puerto Rico into an international hub of export services, retain local talent, attract foreign talent and foreign capital, and create a special fund for promoting the establishment of new businesses to export from Puerto Rico.

The Incentives Code offers a number of benefits to businesses engaged in eligible services in Puerto Rico. The term eligible service includes, but is not limited to:

- research and development;
- advertising and public relations;
- economic, environmental, technology, scientific, managerial, marketing, human resources, information systems, engineering, auditing, and other consulting services;
- advising and consulting on matters related to any industry or business;

- creative industries, including the sale of tickets outside of Puerto Rico or the purchase of said tickets by tourists in Puerto Rico, as well as revenues related to the transmission or the sale of recording rights for audiences outside of Puerto Rico, of shows, musical productions, eSports and fantasy leagues events taking place in Puerto Rico;
- production of engineering and architectural blueprints and designs;
- advanced professional services such as legal, tax and accounting services;
- shared services centers;
- investment banking and other financial services;
- commercial distribution of products manufactured in Puerto Rico to outside markets;
- assembly, bottling and packaging of products for markets outside of Puerto Rico;
- distribution in physical form, network, cloud computing or blockchain and income derived from subscriptions, licensing or fees;
- international trading companies; and
- many other services included within the Incentives Code, as well as any other service designated by the DDEC.

In addition to the 4% income tax rate, and property and municipal exemptions, the export of goods and services enjoy:

- 100% exemption on dividends or profit distributions to shareholder, partners, or members; and
- 100% exemption from property taxes on call centers, corporate headquarters and distribution centers, for the first five years of operations.

Keep in mind rendering services as an employee does not qualify as an eligible business for the incentives for export of goods and services.

International financial and insurance Entities

International financial entities

Provides tax incentives to international financial entities ("IFE") that set up operations in Puerto Rico. The Incentives Code aims to improve the conditions for conducting international financial transactions in Puerto Rico, while simultaneously boosting the island's economy.

A licensed IFE can request a Decree which will enumerate and secure the standardized incentives of the Incentives Code (4% income tax rate, and property and municipal exemptions) for a 15-year period. Additionally, the Decree provides a:

- 6% income tax rate on distributions to shareholders, partners, or members resident of Puerto Rico and
- 100% exemption on distributions to nonresident shareholders, partners, or members of Puerto Rico.

Like other incentives in Puerto Rico, the IFE tax benefits can interplay with other Incentives Code benefits (i.e., individuals), resulting on dividends received fully exempt from Puerto Rico income tax. Dividends paid would also be excluded from federal income tax to the extent they are Puerto Rico source income, and the recipient of the dividend is a bona fide resident of the island.

International insurer/reinsurer

Provides for the establishment of international insurers, branches of international insurers, international reinsurers and holding companies in Puerto Rico to convert the island into an ideal domicile for international insurers. Protected cell plans and securitization plans are allowed.

To qualify as an international insurer or reinsurer, an insurance company must be licensed and regulated by the Puerto Rico Insurance Commissioner.

Generally, an international insurer is one that provides direct insurance only for risks outside of Puerto Rico, although it can provide surplus line coverage and reinsurance for risks located in Puerto Rico.

One of the competitive planning opportunities and advantages Puerto Rico has as a foreign jurisdiction, is that it provides tax planning opportunities as a foreign jurisdiction for federal income tax purposes, while also being a regulated and accredited member of the National Association of Insurance Commissioners (NAIC), the U.S. Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).

International insurers, branches, and international holding companies are given attractive tax treatment under the Incentives Code:

- 4% income tax rate on the excess of \$1,200,000 of eligible income;
- 100% exemption from branch profit tax;
- 100% exemption on dividends or profit distributions, or distributions in liquidation;
- 75% exemption on property taxes; and
- 50% exemption on municipal taxes.

Private equity funds

Seeks to provide Puerto Rico businesses that have limited or no access to public capital markets the opportunity to receive equity capital to promote economic development in Puerto Rico.

Any partnership or limited liability company organized under Puerto Rico law, the U.S. or any other foreign jurisdiction that invests in different securities issued by Entities that, at the time of acquisition, are not publicly traded, qualify as a Puerto Rico private equity fund (“PRPEF”), or a private equity fund (“PEF”).

If the PEF complies with various requirements, tax benefits are:

- 100% exemption from municipal taxes;
- 75% exemption on property taxes;
- special deductions available; and
- Decree with a term of 15 years, renewable for an additional 15 years.
- accredited Resident Investors:
 - o 10% income tax rate on the distributable share of interest and dividends, provided exempt interest or dividends preserve their exempt nature;
 - o 100% exemption on the distributable share of capital gains
 - o 5% income tax rate on capital gains derived from the sale of ownership interest in the PEF, unless the proceeds are reinvested within 90 days in a PRPEF.
- managing and general partners:
 - o 5% income tax rate on the distributable share of interest and dividends;
 - o 2.5% income tax rate on the distributable share of capital gains;
 - o 5% income tax rate on capital gains derived from the sale of ownership interest in the PEF.

Resident investors that invest in a PEF may deduct from taxable income up to a maximum of 30% of their “initial investment” within a period of 10 years, provided that the maximum deduction does not exceed 15% of their net income prior to the deduction.

If the investment is made into a PRPEF, the deduction is 60% of the “initial investment” within a maximum period of 15 years, and with a maximum deduction that does not exceed 30% of the net income prior to the deduction.

The deduction may be claimed for the taxable year that precedes the taxable year in which the “initial investment” is made if it is made prior to the due date for filing the income tax return for the prior taxable year.

Net capital losses derived from investments made in companies that derive at least 80% of its gross income from Puerto Rico sources may be claimed as a deduction.

Hotel and hospitality services

The Puerto Rico tax incentives package offers hotel developers a competitive advantage over developing in other destinations. The incentives aim to facilitate the establishment of tourism development projects throughout Puerto Rico.

Eligibility

Bestows a series of tax credits and incentives to both new and existing tourism businesses that are deemed eligible.

An existing business is one that, at the time of requesting the Decree, is operating a tourism activity and will undertake a substantial expansion or renovation of the existing physical facilities used on the tourism activity.

A new business is defined as one that, at the filing date, will utilize facilities that:

- have not been used for tourism activities during the previous 36 months prior to the filing date;
- have not been used for tourism activities during the previous 18 months prior to the filing date, and the DDEC waives the aforesaid 36-months requirement; or
- irrespective of the above referenced terms, any existing business or property that is subject to an expansion and/or

renovation which exceeds 100% of its acquisition cost or fair market value at conveyance, and said investment is completed within 36 months after the acquisition or conveyance.

The following business activities qualify as tourism activities:

- ownership or administration of:
 - hotels, condohotels, timeshares/vacation clubs, hostels, guesthouses, bed & breakfasts, and inns under the “Posadas de Puerto Rico” program;
 - theme parks, golf courses, marinas for tourism purposes, port facilities in areas that promote tourism activities;
 - natural resources as a source of entertainment value, and;
 - other entertainment or recreational tourism-related facilities.
- leasing or rental of property to an exempt business dedicated to tourism-related activities.

Tax credits

Any Person who acquires an equity interest in an Entity that develops an eligible business, is entitled to choose between two options for the investment tax credit.

- Option 1 – 40% tax credit of the eligible investment made in the tourism project, claimed in three equal installments, beginning on the second year of operations.
- Option 2 – 30% tax credit of the eligible investment made in the tourism project, claimed in four installments
 - 10% in the year the tourism activity secured the financing for the development of the tourism project,
 - with the remaining balance available in three equal installments, beginning when the tourism activity receives its first paying guest.

Since the tax credits may be assigned, transferred or sold, developers typically sell the tax credits in the local Puerto Rico capital market and invest the proceeds into the project. In essence, the tax credit lowers the amount of equity the developer has to come up with as part of the project’s capital structure.

Benefits

Tax incentives include:

- 4% income tax rate on income generated from the eligible activity;
- 12% withholding tax rate on royalty payments, creditable against the 4%;
- 100% exemption from income tax on distributions to shareholders, partners, or members;
- 100% exemption from excise and sales and use taxes on certain raw materials, and machinery and equipment;
- 75% exemption on property taxes;
- 75% exemption from municipal taxes, excises and other taxes to contractors and subcontractors, not including MLT; and
- 50% exemption from municipal taxes;

Cruise-line industry

The cruise industry is one of Puerto Rico's main tourism and economic sectors, not only for its economic impact, but also because of the role it plays in promoting the island's image in the world. Puerto Rico is, in turn, a top-tier destination for the cruise industry.

The incentives strengthen Puerto Rico's competitiveness in the cruise industry, including such key segments within the industry as the supply chain, service providers and cruise-lines.

The law provides a string of incentives to promote transit and homeport cruise visits, spur travel agencies to sell packages to nonresidents that include both a cruise and a stay in a hotel in Puerto Rico; the purchase of products in Puerto Rico; the local procurements of ship maintenance and repair services; and the promotion of excursions for cruise-ship passengers.

The benefits simplify the industry's dealings with the Government making the process of obtaining incentives more efficient, transparent and simple.

The Incentives Code provides cruise-ships a reimbursement system of 10% for food and beverage purchases or engaging maintenance and repair services in Puerto Rico while docked at any Puerto Rico port. An additional 5% is granted for purchases of products manufactured in Puerto Rico, duly certified by the Puerto Rico Industrial Development Company, or agricultural products of Puerto Rico, duly certified by the Puerto Rico Department of Agriculture.

Manufacturing

Promotes businesses established to manufacture products, engage in a wide range of specific economic activities, such as scientific research and development, recycling, hydroponics, value-added activities pertaining to port operations, software development, manufacturing of renewable energy equipment, and aerospace industry research and development.

The tax incentives operate through the issuance of a Decree that lasts for a period of 15 years. The Decree identifies and guarantees the incentives to which the eligible business is entitled.

Benefits

The incentives make industry operations in Puerto Rico highly profitable while stimulating additional economic development.

These include:

- 4% income tax rate on income generated from the eligible activity;
- 12% withholding tax rate on royalty payments, creditable against the 4%;
- 100% exemption from income tax on distributions to shareholders, partners, or members;
- 100% exemption from excise and sales and use taxes on certain raw materials, and machinery and equipment;
- 75% exemption on property taxes;
- 75% exemption from municipal taxes, excises and other taxes to contractors and subcontractors, not including MLT;
- 50% exemption from municipal taxes; and
- Tax credits available.

Renewable/highly efficient energy

Puerto Rico has entered a new age in terms of its diversification of energy sources with the implementation of a new public energy policy and programs to diversify energy sources, ensuring that the generation of electricity on the island is affordable, viable and sustainable.

The incentives provide benefits for Entities dedicated to the production of renewable or highly efficient energy on a commercial scale, in addition to the standardized benefits mentioned above (i.e., 4% income tax rate and municipal and property tax exemptions), the Entity may benefit from:

- 12% withholding tax rate on royalty payments, creditable against the 4%;
- 100% exemption from income tax on distributions to shareholders, partners, or members;
- 100% deductibility of investment in buildings, structures, and machinery and equipment;
- 100% exemption from excise and sales and use taxes on certain raw materials, and machinery and equipment;
- 75% exemption on property taxes;
- 75% exemption from municipal taxes, excises and other taxes to contractors and subcontractors, not including municipal license taxes;
- 50% exemption from municipal taxes;
- Tax credits available.

An eligible business totally disconnected from the electric system of the Puerto Rico Electric Power Authority or “PREPA” for its acronym, is not required to sell the energy produced to PREPA to receive or keep the Decree.

The types of energy considered alternative or sustainable renewable energy are:

- landfill gas combustion;
- anaerobic digestion;
- fuel cells;
- waste heat;
- solar energy;
- eolic energy;
- geothermal energy;
- renewable biomass combustion;
- renewable biomass gas combustion;
- combustion of biofuels derived from renewable biomass;
- qualified hydropower;
- marine and hydrokinetic energy; and
- ocean thermal energy.

Agroindustry

Puerto Rico provides incentives to promote the sustainable growth of the island’s agricultural sector. The Incentives Code provides tax benefits to bona fide farmers and agricultural businesses.

Eligibility

A livestock and agro-industrial business must engaged in the operation and conduct in Puerto Rico one or more of the following businesses:

- farming and/or cultivation of land for the production of fruit and vegetables, spices for condiments, seeds, and all kinds of foodstuffs for human beings or animals, or raw material for other industries;
- raising of animals for the production of meat, milk and eggs, among others, to be used as foodstuff for human beings, or raw material for other industries;
- breeding of thoroughbred race horses; breeding of “paso fino” horses, and breeding of saddle horses;
- agricultural or livestock operations that buy raw materials produced in Puerto Rico, as long as they are available;
- the producers, pasteurizers and sterilizers of milk and their agents, as long as the milk that is used is taken from the milking done in Puerto Rico;
- operations engaged in the packing, crating or labeling of fresh agricultural produce cultivated in Puerto Rico that are part of the same agricultural business. The operations that are exclusively devoted to the packing, crating or labeling of agricultural produce do not constitute an agricultural business per se;
- commercial marine fishing and aquaculture;
- commercial production of ornamental flowers, plants, and grasses for the local and export market, without including the professional services of landscape designers;
- cultivation of vegetables by hydroponic methods, the buildings and other equipment used for these purposes;
- production of grain by bona fide farmer’s associations to be consumed by agricultural enterprises; or
- breeding of fighting cocks and for the production of spurs.

An existing bona fide farmer with an agricultural or livestock business is considered eligible if it:

- derives 51% or more of the gross income from an agricultural business as an operator, owner or tenant as recorded in the corresponding income tax return; or
- derives 51% of the production value and/or investment of an agroindustry business as an operator, owner or tenant.

Benefits

- 90% exemption from income tax, on income derived directly from the eligible business.
 - it does not apply to interests, dividends, royalties, or gains derived from the sale of assets, including those assets used in the eligible business, or any other income derived from the eligible business, which does not directly proceed from the eligible activity;
- stockholders, members, or partners are subject to income taxes on the dividends distributed by the eligible business (when it is taxed as a corporation in Puerto Rico);
- 100% exemption from income tax on interest on bonds, promissory notes and other debt instrument for debts issued on and after January 1, 1996, by bona fide farmers and financial institutions defined under Act No. 4 of 1985, or issued in authorized transactions by the Commissioner of Financial Institutions, related to the financing of the eligible businesses;
- 100% exemption from property taxes, including real and personal, tangible, intangible property (such as land, buildings, equipment, accessories, and vehicles), if they are owned, leased, or held in usufruct by a bona fide farmer, and used in 35% or more in the eligible activities;
- 100% exemption from municipal license taxes;
- 100% exemption from excise and sales and use taxes on certain articles imported or directly/indirectly acquired for use in eligible activities;
- 100% exemption from the payment of Internal Revenue stamps and registry fees in the execution and registration of documents in the Puerto Rico Property Registry; and
- incentives for agricultural research.

The Incentives Code also provides the following benefits:

- an annual bonus for agricultural workers between of \$165 or 4% of the annual salary of the employee, whichever is greater, up to \$235, and
- a wage subsidy program for eligible farmers.

Film industry and creative services

Puerto Rico's film industry has two pillars:

- the island as a film destination and
- that actual films produced locally.

Film incentives have made the island an ideal location in which to shoot movies in the development and post production stage.

Film industry

The benefits aim to bring Puerto Rico's production cost structure in line with other leading jurisdictions through innovative and competitive tax incentives. In recognition of the importance of complementing a low-cost structure with state-of-the-art, especially dedicated infrastructure, the benefits also provide for numerous incentives for the development and operation of related infrastructure, specifically high-capacity production studios.

Production incentives

Besides the standardized tax incentives mentioned above (4% income tax rate and municipal and property tax exemptions), film industry services enjoy:

- 40% tax credit on all payments to Puerto Rico residents;
- 20% tax credit on all payments to nonresident talent (including stunt doubles). Payments made to nonresident talent are subject to a 20% withholding;
- up to 15% tax credit of Puerto Rico production expenses, excluding payments made to a foreign Person, in full-length films, series or documentaries in which a domestic producer is in charge of the Film Project, and the director, cinematographer, editor, production designer, post-production supervisor or the line producer are domestic Persons, up to a maximum of \$4 million of the tax credit per Film Project.
- qualifying projects:
 - feature films;
 - short films;
 - documentaries;
 - television programs;
 - episodic series;
 - mini-series;
 - music videos;
 - national and international commercials;
 - video games;

- o recorded live performances; and
- o original soundtrack recordings and dubbing.
- 100% exemption from income tax, withholding or sales and use tax, on personal property rent payments made by the eligible business to nonresident and foreign Persons not engaged in trade or business in Puerto Rico, to the extent said personal property is used in eligible activities;
- 20% income tax rate on income generated or paid as compensation to nonresident individuals or to an Entity that hires such nonresident individuals, to provide services in Puerto Rico in connection to a Film Project;
- 100% exemption from excise and sales and use taxes on certain raw materials, and machinery and equipment;
- 100% exemption from income taxes on partial or full liquidation distributions made out to its stockholders, partners, or members to the extent such distributions are attributed to the income derived from eligible activities;
- 75% exemption from municipal taxes, excises and other taxes to contractors and subcontractors, not including municipal license taxes; and
- Decree for the duration of the Film Project, as determined by the Secretary of the DDEC. Decrees issued for Studio Operators have a 15-year term.

Entrepreneurship

Aims to retain young talent in Puerto Rico and stimulate the return of those young professionals that have moved out of the island.

It applies to any individual resident of Puerto Rico, whose age fluctuates between 16 and 35 years old, interested in creating and operating a long-term new business in Puerto Rico, for an indefinite term, who has obtained a high school diploma or equivalent certification from the Puerto Rico Department of Education, or duly certifies that is currently studying in high school.

Benefits include:

- 100% exemption from income tax on the first \$500,000 of the net income subject to tax;
- Stockholders, members, or partners are subject to income taxes on the dividends distributed by the eligible business (when it is taxed as a corporation in Puerto Rico) or profits distributions from the eligible business (when it is taxed as a partnership in Puerto Rico);

- 100% exemption on personal property taxes; and municipal license taxes.
- Decree has a term of three years.

Specific requirements for the business are:

- commence operations on or after filing application;
- operated exclusively by the eligible individual;
- not been operated through an affiliate or is the result of a reorganization; and
- the benefits are limited to one new business per eligible individual.

Business incubators

Explore ways to stimulate the expansion of business incubators in Puerto Rico, by adopting the incentives set forth herein to strengthen entrepreneurship and seek the necessary training for the creation of sustainable businesses that generate new jobs. The funds provided for these benefits will come from the Economic Incentives Fund.

Foreign trade zones (FTZs)

Puerto Rico has the largest noncontiguous FTZ system in the U.S. The system allows Entities to obtain significant financial savings, since raw material, components, and packaging can be transported tax-free throughout these zones and items shipped abroad after processing are exempt from federal taxes.

Benefits include:

- deferment of federal customs duties;
- deferment of Puerto Rico excise taxes;
- 100% exemption on MLT on exports outside of the U.S.;
- 100% exemption on tangible property and equipment used;
- 60% exemption on the value of the property that is designated intangible; and
- 100% exemption on exports from the zone and sub-zones.

Priority Projects in qualified opportunity zones

Adopted as part of the Tax Cuts and Jobs Act of 2017 (“TCJA”), the opportunity zones program (“OZ Program”), was designed to attract private investment into economically distressed areas. US Tax Code §1400Z-1, paves the way for low-income communities to be designated as qualified opportunity zones (“OZs”). Meanwhile, §1400Z-2 offers federal income tax incentives to a taxpayer who invests capital gains in a business located within an OZ.

Approximately, 98% of Puerto Rico has been designated as an OZ, which creates an attractive investment alternative for U.S. investors.

OZs in Puerto Rico

Initially included in Act No. 21 of 2019, known as the Puerto Rico Economic Development and Opportunity Zones Act of 2019 (“Act 21”), §6070.54 through §6070.69 of the Incentives Code, incorporates almost identically the provisions of Act 21.

The Incentives Code states that it is the public policy of the Government to make the island an investment destination for qualified opportunity funds (“OZ Funds”) that invest in Priority Projects located in OZs.

The OZ rules adopted in Puerto Rico:

- amended §1031.06 of the PR Tax Code to adopt a provision equivalent to §1400Z-2 of the US Tax Code, regarding the special rules for capital gains invested in OZ Funds to allow for capital gains subject to Puerto Rico income tax to be taxed at preferential rates; and
- created a new incentives program for Priority Projects located in OZs (“PP Program”).

The Incentives Code adopts the OZ Priority Project Committee (“OZ Committee”) originally adopted by Act 21, composed of seven members.

Eligible investment

Means the cash contributed to:

- an OZ Fund in exchange for stock or interest;
- an OZ Fund in exchange for stock or interest, and the OZ Fund invests the contributions as capital in an eligible business in exchange for stock or interest, and the investment is in qualified opportunity zone property (“OZ Property”); or

- an Entity that is an eligible business in exchange for stock or interest, if an OZ Fund invests in such Entity and the investment is in OZ Property.

Eligible business

Means a business that meets the following requirements:

- the business activity is performed in its entirety in an OZ;
- the business activity performed is not eligible for a Decree under the Incentives Code prior tax incentives laws;
- the business activity is performed by an OZ Fund or an Entity that invests in OZ Property; and
- the business activity performed is a Priority Project.

A business in the export services, manufacturing, tourism, energy and film sectors are not precluded from benefitting from the special treatment of capital gains invested in an OZ Fund. Rather, they will not be able to benefit from the investment credit provided that those businesses may seek to obtain a Decree to cover their activities under the corresponding chapter of the Incentives Code, according to the nature of the business activity.

Priority Projects

A Priority Project is defined as a trade or business or other activity for the production of income that contributes to the social and economic diversification, recovery or transformation of the community in the OZ.

The OZ Committee published Resolution 2019-01 on August 19, 2019, to approve and adopt a list of the initial Priority Projects (“OZ List”). The OZ List shall be revised annually. Currently, no new revised OZ List has been published.

The Priority Projects included within the OZ List are considered eligible to apply for a Decree. If a proposed project is not on the OZ List, the proponent shall request the designation of the project as a Priority Project from the OZ Committee before filing an application for a Decree.

Commercial activity

Means any activity engaged in the primary purpose of making a profit. Commercial activity, including operating, investing and financial activities, are ongoing and focused on creating value for shareholders.

Commercial activity within the OZ List

The OZ List includes four eligible activities designated as Priority Projects for which a Decree may be requested:

- development (acquisition of property and construction thereon and/or substantial improvement of existing property) of residential real property that is a low-income housing project, as defined in §42(g) of the US Tax Code, or by the Puerto Rico Department of Housing, for sale or rent;
- development (acquisition of property and construction thereon and/or substantial improvement of existing property) of residential or commercial real property for sale or rent;
- development (acquisition of property and construction thereon and/or substantial improvement of existing property) of industrial real property for sale or rent;
- substantial improvement of an existing commercial property for sale or rent.

Priority Projects tax benefits

An approved Decree includes the following tax incentives:

- 18.5% income tax rate on income generated from the eligible activity;
- 18.5% withholding tax rate on royalty payments;
- 100% exemption from income tax on distributions to shareholders, partners, or members;
- 100% exemption for interest income received on bonds, promissory notes, or other obligations of an eligible business for the development, construction, or rehabilitation of, or improvements to an eligible business;
- 25% exemption on property taxes;
 - municipalities may provide an additional exemption up to 75% by municipal ordinance;
- 25% exemption on municipal license, excise, and any other municipal taxes;
 - municipalities may provide an additional exemption up to 75% by municipal ordinance;
- guaranteed 5% transferrable investment tax credit which may be increased to 25%.
- special permit process.
- Decree has a term of 15 years.

Other economic development programs

Public-private partnerships

Puerto Rico has embraced public-private partnerships as a way to leverage the capital and expertise of the private sector with the management and oversight of the Government to provide the public with needed assets and services. Several projects are underway. Please contact us should you be interested in obtaining more information.





Expatriates

Expatriates

Expatriates taking up employment in Puerto Rico are subject to comprehensive tax and employment visa requirements. The United States 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.

Facts

Employment 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.

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.

Tax year

Pursuant to the PR Tax Code, 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
\$9,001 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

As mentioned above when discussing the tax system for individuals, 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.

Sample of income tax calculation for year ending on December 31, 2020:

Taxable income	USD
Employment income	\$ 74,500
Benefits provided (i.e., housing)	28,200
Gross income	102,700
Less:	
Qualified pension contributions (employee)	(10,000)
Overseas workdays (20% of gross income)	(20,540)
Personal allowance	(7,000)
Taxable income	65,160
Tax bill *	8,867

* 92% of the sum of the regular tax and the gradual adjustment.

Basis of taxation

Residency

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.

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. citizen of Puerto Rico, 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%.

Resident expatriates will have their tax withheld at source at the applicable tax rates [see applicable tax rates on the "Tax rates for 2020" section above].

Source of employment

As previously stated, when services are performed in Puerto Rico, the income is sourced to Puerto Rico and, thus, subject to Puerto Rico taxation for both residents and nonresidents. In the case of resident expatriates, all other worldwide income is also subject to Puerto Rico taxation.

Benefits (in kind)

In general, when the benefit is enjoyed in Puerto Rico, an income tax charge should arise. Therefore, housing, meal allowances, provision of car or relocation allowances, may be subject to Puerto Rico income tax. This taxation is in addition to the tax of the expatriate's salary if these are considered compensation and not reimbursement of expenses incurred while away from the expatriate's tax home.

Expatriate concessions

There are no expatriate concessions in Puerto Rico.

Relief for foreign taxes

In the case of resident expatriates, a foreign tax credit may be claimed for taxes paid to any foreign country (including the U.S.), on foreign income (including U.S. income) reported in Puerto Rico.

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 would not be 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.

What taxes?

Capital gains tax

As of 2020, long-term capital gains are subject to a maximum rate of 15%. Short-term gains (one year or less) are subject to the regular income tax rates. An expatriate's exposure to income tax on capital gains is determined by their Puerto Rico tax residence status and source of capital gain.

Under the provisions of the PR Tax Code, capital gain source of income on the sale of personal property, in general, depends on the residence status of the taxpayer. Generally, capital gains tax is assessed on net gains after deducting the cost of acquisition of the asset from sale proceeds.

Inheritance, estate and gift taxes

Effective January 1, 2018, Puerto Rico repealed estate and gift taxes. A requirement for filing estate and gift tax returns depends on the expatriate's Puerto Rico tax residence and domicile position. Nonresident expatriates are subject to reporting only upon the transfer of Puerto Rico property.

Investment income

The expatriate's tax residence status and source of income determine whether investment income such as interest, dividends, etc., is subject to Puerto Rico income tax.

Local taxes

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

Real estate tax

Real estate tax rates fluctuate from 8.03% to 12.33%, depending on the municipality where the property is located.

Expatriates are affected only if they own real property located in Puerto Rico (i.e., a house in Puerto Rico).

Social security taxes

The U.S. social security contributions apply in Puerto Rico on the same basis and rates as in the Mainland. Please refer to these rules to determine how they may affect your assignments to Puerto Rico.

Stock options

Stock options may be qualified or nonqualified. The tax advantages of qualified stock options are generally the deferral of the imposition of the income tax on compensation and generating a capital gain later when the shares are disposed of after holding them for at least one year and a day.

Wealth tax

There is no wealth tax in Puerto Rico.

Other specific taxes

There are no other specific taxes related to expatriates in Puerto Rico.

Tax planning opportunities

Where a foreign assignment continues to exist and part of the expatriate's duties are performed outside of Puerto Rico, any employment income received with respect to the foreign duties remain not subject to Puerto Rico tax, provided the expatriate is not a resident of Puerto Rico.

Our tax team can help expatriates and their employers identify Puerto Rico's tax planning opportunities and review tax equalization policies, as well as providing compliance services regarding United States and Puerto Rico's tax filing requirements.

Contact details



Lina Morales

Partner | Head of Tax
E lina.morales@pr.gt.com



María de los Angeles Rivera

Tax partner | IBC Director
E maria.rivera@pr.gt.com



Francisco Luis

Tax partner
E francisco.luis@pr.gt.com



Isabel Hernández

Tax partner
E isabel.hernandez@pr.gt.com

Puerto Rico International Business Center (IBC)

33 Bolivia Street Suite 400
San Juan, Puerto Rico 00917-2013

Varey Building
36 Cristina Street
Ponce, Puerto Rico 00733

T +1 787 754 1915
E kgt@pr.gt.com

www.grantthornton.pr



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