

DOING BUSINESS

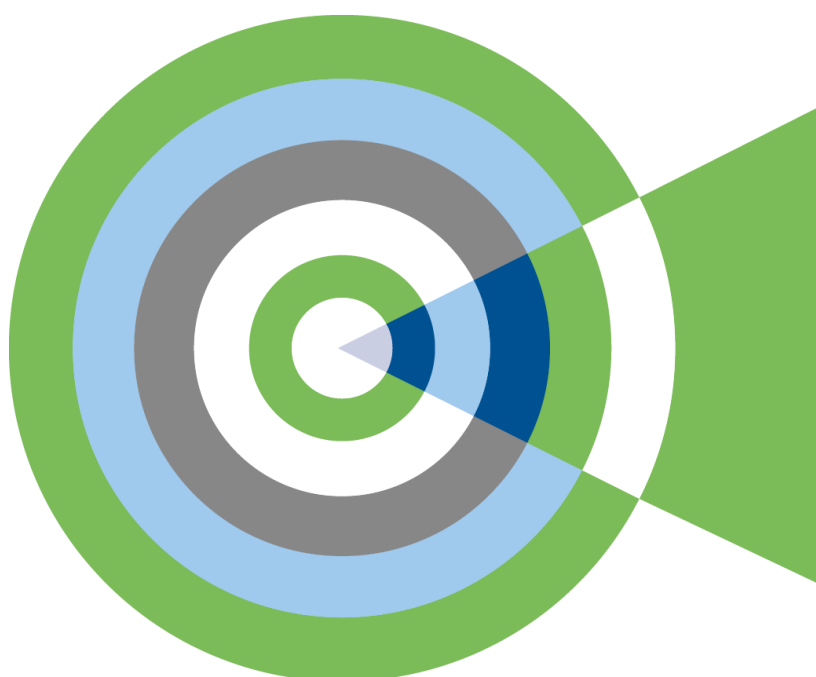
IN PUERTO RICO



The network
for doing
business

CONTENTS

1 – Introduction	3
2 – Business environment	4
3 – Foreign Investment	5
4 – Setting up a Business	18
5 – Labour	25
6 – Taxation	29
7 – Accounting & reporting	32
8 – UHY Representation in Puerto Rico	34



1 – INTRODUCTION

UHY is an international organisation providing accountancy, business management and consultancy services through financial business centres in around 100 countries throughout the world.

Business partners work together through the network to conduct transnational operations for clients as well as offering specialist knowledge and experience within their own national borders. Global specialists in various industry and market sectors are also available for consultation.

This detailed report providing key issues and information for investors considering business operations in Puerto Rico has been provided by the office of UHY representatives:

UHY DEL VALLE & NIEVES PSC

PO Box 361863

San Juan, PR 00936-1863

Puerto Rico

Phone +1 787 793 4650

Website www.uhy-pr.com

You are welcome to contact [Rafael Del Valle-Vega \(r.delvalle@uhy-pr.com\)](mailto:r.delvalle@uhy-pr.com) for any inquiries you may have.

A detailed firm profile for UHY's representation in Puerto Rico can be found in section 8.

Information in the following pages has been updated so that they are effective at the date shown, but inevitably they are both general and subject to change and should be used for guidance only. For specific matters, investors are strongly advised to obtain further information and take professional advice before making any decisions. This publication is current as of July 2021.

We look forward to helping you do business in Puerto Rico.

2 – BUSINESS ENVIRONMENT

The Commonwealth of Puerto Rico is a semi-autonomous territory of the United States located in the north-eastern Caribbean, east of the Dominican Republic and west of the Virgin Islands.

Puerto Rico has a republican form of government, which is subject to the jurisdiction and sovereignty of the United States of America. The president of the United States is the head of state.

The government of Puerto Rico is composed of three branches – executive, legislative, and judicial. The executive branch is headed by the governor. The legislative branch consists of a bicameral legislative assembly made up of a Senate and a House of Representatives. The judicial branch is headed by the Chief Justice of the Puerto Rico Supreme Court. The governor and legislators are elected by popular vote every four years. The governor, with the advice and consent of the Senate, appoints members of the judicial branch.

Puerto Rico has 78 municipalities. Each municipality has a mayor and a municipal legislature elected for a four-year term.

POPULATION

According to the 2020 U.S Census of Puerto Rico the revised population estimate is approximately 3.2 million people.

AREA

The territory is 9,104 square kilometres (3,515 square miles), including the neighbouring islands of Vieques and Culebra. The maximum length from east to west is 180km (110 miles) and the maximum width from north to south is 64km (40 miles).

CURRENCY

The currency of the territory is the US dollar (USD).

LANGUAGE

The official languages are Spanish and English, with Spanish being the primary language.

THE ECONOMY

Puerto Rico had an estimated per capita gross domestic product (GDP) of USD \$26,822 in 2020.

UNEMPLOYMENT

The unemployment rate in Puerto Rico is around 8.5% (as at February 2019).

3 – FOREIGN INVESTMENT

FINANCING

Credit for financing a business may be obtained from commercial banks doing business in Puerto Rico including United States or foreign banks.

In addition, the Government Development Bank for Puerto Rico (GDB) may provide financing.

An affiliate of the GDB, the Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA), also provides an alternative method for financing investment capital in Puerto Rico for projects in the public and private sectors in order to promote economic development.

In addition, the Economic Development Bank, which targets small- and medium-sized entrepreneurs, is another source for financing a business.

INCENTIVES

Puerto Rico has approved legislation intended to provide the right opportunities for continued development of local industry, to offer an attractive tax environment for foreign investment and promote economic development and social improvement in Puerto Rico.

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.

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.

One of the most significant changes introduced by this regulation is the increase in application fees for incentives under Act 60. As stated in Article 6020.01(b)(3)-1 of the regulation, these are the most frequent application fees:

- Individual investors - \$5,000
- Exporting of goods and services - \$1,000
- Young entrepreneurs - \$100
- Manufacturing - \$1,000
- Infrastructure and green energy - \$1,000
- Agroindustries - \$1,000
- Creative industries - \$1,000

Seeking 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.

With this purpose in mind, several incentive acts for specific types of industries or services have been enacted and are described below:

- Small and medium business (PYMES)
- Tourism & Cruise-ship industry
- Film & creative industries
- Foreign Trade Zones
- Manufacturing
- Green energy and infrastructure
- Agro-industrial activities
- Export of goods and services
- Resident individual investors
- International Financial Entities (IFEs), International Insurers and reinsurers
- Entrepreneurship for young individuals
- Priority Projects for qualified opportunity zones (OZs)

Incentives Act for the Retention and Return of Medical Professionals of 2017

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.

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

Grants 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, condo hotels, 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.

Because 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 must 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.

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 postproduction 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 fulllength 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;
 - recorded live performances; and
 - 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.

GREEN ENERGY INCENTIVES

Puerto Rico is entering 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.

These incentives provide benefits for entities committed to the production of renewable or highly efficient energy on a commercial scale, in addition to the standardized benefits stated 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.

AGROINDUSTRY

Puerto Rico offers incentives to promote the organic 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 engage 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 additionally 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.

EXPORT OF GOODS AND SERVICES

The main objectives of the Export of Goods and Services is 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 goods and services from Puerto Rico.

The Act includes, but is not limited to, the following types of designated business activity (among many others):

- research and development;
- advertising and public relations;

- economic, environmental, technological, scientific, managerial, marketing, human resources, information systems, engineering, auditing, and other consulting services;
- advising and consulting on matters related to any industry or business;
- commercial art and graphic services;
- production of engineering and architectural blue prints and designs;
- advanced professional services such as, legal, tax and auditing services;
- centralised managerial services including, but not limited to, strategic direction, planning and budgeting performed for affiliated entities and by a regional headquarters;
- electronic data processing 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.

Benefits

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.

It must be noted that rendering services as an employee does not qualify as an eligible business for the incentives for export of goods and services.

ACT TO PROMOTE THE RELOCATION OF INDIVIDUAL INVESTORS TO PUERTO RICO

The Act aims to mobilize investments (mutual funds, stocks, fixed income) from outside the country to Puerto Rico, through the relocation of individuals (resident individual investors – RII) 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.

The implementation of the Act aims to boost the economy of Puerto Rico through the consumption and investment of the new residents.

A Few of the tax incentives are:

- 100% exemption from income tax on certain passive income (i.e., interest, dividends).
- 100% exemption on all income from P.R. sources pursuant to IRC Sec. 933 of the US Tax Code (if individual complies with the residency 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 P.R., 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 increase 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.

Several requirements must be met each year in order to be in compliance with DDEC.

INTERNATIONAL FINANCIAL ENTITIES

With the objective of making Puerto Rico an international banking and financial center the government provides tax incentives for new banking and financial entities that set up operations in Puerto Rico for clients outside of Puerto Rico.

Provides tax exemptions to businesses engaged in eligible activities in Puerto Rico. To avail from such benefits, a business needs to become an International Financial Entity (“IFE”) by applying for a permit and license and obtaining a tax exemption decree.

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 non-resident shareholders, partners, or members of Puerto Rico.

Similar to 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.

These insurance entities are 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.

ENTREPRENEURSHIP

The purpose is 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.

Advantages include:

- 100% exemption from income tax on the first \$500K 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.

Certain 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.

FOREIGN TRADE ZONES INCENTIVES

Puerto Rico has the largest non-contiguous Foreign Trade Zone (FTZ) system in the United States.

The system allows companies to obtain significant financial savings, since raw materials, components and packaging can be transported tax-free throughout these zones and items shipped abroad (after processing) are exempt from US tax.

Advantages include:

- deferral of federal customs duties;

- deferral 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.

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 continues for a period of 15 years. The Decree identifies and guarantees the incentives to which the eligible business is entitled.

Advantages

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.

PRIORITY PROJECTS IN QUALIFIED OPPORTUNITY ZONES

Implemented as part of the Tax Cuts and Jobs Act of 2017 (“TCJA”), the opportunity zones program (“OZ Program”), was created to attract private investment into economically distressed areas. US Tax Code §1400Z-1, overlays 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.

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

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.

4 – SETTING UP A BUSINESS

There are many ways in which a business may be set up in Puerto Rico and the most common alternatives are set out below.

CORPORATION

A corporation is a legal form of organization used to carry on a business enterprise. It is an entity separate and distinct from its shareholders, directors and officers.

A corporation has the power to enter into contracts and to hold property in its own name, to sue and be sued in its own name, to have continuity of life and free transferability of ownership interests.

Additionally, the liability of corporate shareholders for the acts of the corporation, except in certain cases, is limited to their investment in its stock. Management of the corporation is centralized in its board of directors.

PUERTO RICAN CORPORATIONS

Any natural person with legal capacity or any juridical person singly or jointly with another, may incorporate or organise a corporation by filing to the Department of State of Puerto Rico a certificate of incorporation which shall be executed, acknowledged, filed and recorded in accordance with the provisions of the General Corporation Law of Puerto Rico of 2009.

NON-PUERTO RICAN CORPORATIONS

Any corporation organized under the laws of any jurisdiction other than the Commonwealth of Puerto Rico may request a certificate of authorisation to do business in Puerto Rico by filing to the Department of State of Puerto Rico an application setting forth the information required by the General Corporation Law of Puerto Rico of 2009.

The approval to do business within Puerto Rico is usually granted as a matter of course as long as no other corporation is doing business under the same name and as long as the activity the corporation intends to pursue is one permitted under the law.

No foreign corporation shall do any business in the Commonwealth of Puerto Rico until it receives authorisation to do so, pursuant to the procedures established in the law.

A foreign corporation may establish a branch in Puerto Rico by filing the documents required.

ANNUAL CORPORATION REPORT

Every corporation (domestic or foreign) is required to file an annual corporation report with the Puerto Rico Department of State on or before 15 April each year. A USD 150 annual fee is payable when filing the report.

The report must include a balance sheet prepared to generally accepted accounting principles, showing the financial condition of the Puerto Rican operations of the corporation at the close of its year. The balance sheet must be audited and certified by a certified public accountant with a licence from the Commonwealth of Puerto Rico. The auditor's opinions must have the stamp from the Puerto Rico Association of Certified Public Accountants and the accountants' seal.

The balance sheet must be duly certified by a certified public accountant licensed in Puerto Rico only when the volume of business of the corporation exceeds USD 3,000,000. A non-Puerto Rican corporation whose volume of business does not exceed USD 3 million must include a balance sheet compiled by a certified public accountant in Puerto Rico.

The Annual Corporation Report is a public document available for anyone to see at the premises of the Department of State.

PARTNERSHIP

A partnership is an organisation of two or more persons who carry on business for profit.

It is a legal entity which can own property and sue or be sued in its own name. As a general rule, each member of a partnership is liable for the debts of the business and is held liable for the partnership's obligations.

Partnerships are subject to income taxes on the partnership's income. The liability for taxes applies regardless of whether the partnership's profits are distributed or retained.

Similarly, a distribution of the partnership profits is taxable to the recipient at a 10% rate, if the distribution is made by a domestic partnership or certain foreign partnerships.

LIMITED LIABILITY PARTNERSHIP

A limited liability partnership is a partnership formed by no less than two natural persons under the provisions of the Limited Liability Partnership Act, including those rendering professional services, or a related limited liability partnership. Its name must be followed by the words 'limited liability partnership' or 'sociedad de responsabilidad limitada', or the abbreviation 'L.L.P.', 'LLP', 'S.R.L.' or 'SRL'.

To be considered as a limited liability partnership, it must register with the Department of State by filing a certified copy of the constituent deed accompanied by payment of a USD 150 fee. The deed must contain the partnership name, the address of the principal office, the name and address of the managing partner and of each partner, and a brief description of the business.

A foreign limited liability partnership must also submit an application for registration, including the jurisdiction in which it was registered and the name of the person designated to receive summons.

A partner of a limited liability partnership is personally liable for the partnership obligations solely to the extent of his contribution to the partnership. He is not generally responsible for the obligations of other partners arising as result of error, omission, negligence, incompetence, or illicit acts committed by another partner, or employee, agent, or representative of the partnership.

LIMITED LIABILITY COMPANY

A limited liability company is a corporation formed by one or more persons who have executed the Limited Liability Company Certificate of Formation and filed it with the Puerto Rico Department of State. The certificate must state the name, address of the registered office and name and address of its resident agent. The company name must be followed by the words 'Limited Liability Company' or 'Compañía de Responsabilidad Limitada', or the abbreviations 'LLC', 'L.L.C.', 'CRL' or 'C.R.L.'. The fee (currently in force) needs to accompany the Limited Liability Company Certificate of Formation.

A foreign LLC may register in Puerto Rico by providing a petition signed by an authorised person following the procedures specified in the General Corporation Act. When registered, it shall have some powers as a domestic LLC, provided that a foreign LLC's internal affairs and the liability of its manager and members shall continue to be governed by laws of the jurisdiction where the LLC is organised.

A LLC may engage in any lawful activity. Each LLC must maintain a registered office and resident agent for services of process in Puerto Rico. A LLC is required to prepare the LLC Agreement, which sets out the duties of the LLC to its managers and members, and duties of these to the LLC and to each other, as well as the management structure of the LLC, the rights of the management and members and their respective share of interest in the LLC profits and losses.

Unless otherwise provided in the LLC Agreement, no manager or member is personally liable for the LLC's obligations solely by reason of being a manager or member of the LLC.

An annual fee needs to be filed each year with the Puerto Rico Department of State with a payment of USD 150 in order to maintain a good standing with the agency.

CORPORATION OF INDIVIDUALS

A corporation of individuals is a corporation with only one class of stock and having no more than 75 shareholders who are individuals, estates, or certain trusts.

With limited exceptions, a corporation of individuals is not taxed at the corporate level; instead the items of income, loss, deduction, and credit are passed through to, and taken into account by, its shareholders or partners in computing their individual tax liabilities.

The corporation must be created under the laws of the Commonwealth of Puerto Rico or a corporation created under the laws of any state of the United States or the District of Columbia whose trade or business is exclusively in Puerto Rico, except for:

- An insurance company
- A registered investment company
- A special corporation owned by employees

- A corporation exempt under any tax incentives or similar acts, except under the Tourists Development Act
- Other exempt corporations
- A financial institution
- A corporation licensed as a capital investment fund.

Certain partnerships may also elect to be treated as a corporation of individuals. The election to be considered as a corporation of individuals must be made by filing a Subchapter N Election with the Puerto Rico Treasury Department.

Generally the corporation (or partnership) can make the election for any taxable year:

- 1) At any time during the preceding tax year, or
- 2) At any time before the 15th day of the fourth month of the tax year, if filed during the tax year the election is to take effect.

TAX CONSEQUENCES OR CONSIDERATIONS FOR THE CORPORATION OF INDIVIDUALS

An electing corporation (or partnership) which used the LIFO inventory method, flexible or accelerated method of depreciation, long-term completed contract, or instalment sales method for the tax year prior to the election to be treated as a corporation of individuals, must recapture as income these items in the last year before the election is made. The increase in tax resulting from the recapture is payable with the final income tax return of the regular corporation (or partnership), except for the tax resulting from the LIFO recapture which is payable in three equal instalments over three taxable years. The first instalment is payable with the final return of the regular corporation (or partnership).

All accumulated earnings and profits of an electing corporation are deemed distributed during the first two years of the election and are generally subject to the 10% special tax on eligible distributions.

Before making the election, a corporation (or partnership) may be subject to a built-in gains tax at the corporate level during the ten-year period beginning on the first day of the corporation's first tax year as a corporation of individuals.

REAL ESTATE INVESTMENT TRUSTS

A real estate investment trust (REIT) is a tax designation reserved for corporations investing in real property which 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 government agencies, departments or corporations of the government of Puerto Rico;
- manufacturing buildings and related facilities;
- recreational centers;
- parking facilities;
- shopping facilities and centers;

- buildings purchased from the Government of Puerto Rico, its agencies and instrumentalities;
- hotels.

To qualify as a REIT under the Puerto Rican code, an entity must:

- be organized as a corporation, partnership, trust, or association;
- have 20 or more shareholders or partners 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 qualified 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;
- at the end of the first quarter of its first year as a REIT, have 50% or more of the total value of all the outstanding shares or participation certificates owned by more than five individuals.

A REIT also needs 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) which 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; and
- gains from the sale or disposition of real property;
- qualified temporary investment income; and
- income from the purchase of property to be remodelled and rented.

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

- rents 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 other disposition of real property which is not of the type of property that qualifies 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, and
- 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.

REITs organized under the laws of the United States or a state of the United States (US REIT) must meet the following requirements to be treated as a REIT under the PR Code:

- The US REIT must have qualified as such under the US Internal Revenue Code during the taxable year
- The US REIT must invest in real property located in Puerto Rico and constructed after 30 June 30 1995
- The US REIT must file with the Puerto Rico Treasury Department, not less than 30 days before the first taxable year in which it wishes to be regarded under the PR Code as an exempt REIT, a sworn statement with the information required by the Department.

PUBLIC-PRIVATE PARTNERSHIPS

Act No. 29 of 8 June 2009 codified Puerto Rico's policy favouring the use of Public-Private Partnerships (PPPs) – contractual agreements between government agencies and private or non-governmental entities – as a means for achieving greater private sector participation in the development and financing of infrastructure and services, especially for priority projects, which include:

- Landfills
- Water reservoirs
- Power plants which use alternative sources of energy or renewable sources of energy
- Transportation systems
- Health, security, education, correctional and rehabilitation facilities
- Low-income housing projects
- Facilities for sport, recreation, tourism and cultural activities
- Ground and wireless communication systems
- High-technology information and mechanical systems
- Any other kinds of activity, facility or service identified as a priority project through legislation.

Act No. 29 creates a Public-Private Partnership Authority as a public corporation of the government of Puerto Rico, attached to the Government Development Bank for Puerto Rico (GDB). The Authority is designated as the sole government entity authorised and responsible for implementing the public policy on partnerships and for determining the functions, services or facilities for which such partnerships are to be established.

The Authority shall establish priorities in the development of projects, in order for partnership contracts to address infrastructure needs or services which are a priority for the government of Puerto Rico. The Authority, with the support of the GDB, shall conduct analysis on the desirability and convenience of the project as necessary to determine whether it is advisable to carry out the project and establish such a partnership.

Generally, contractors in a partnership established under the PPP Act receive special tax treatment. For example, such contracts will typically pay a fixed income tax rate of 10% over the net income derived from the operations provided in the Partnership Contract and receive exemptions from paying taxes on personal property.

BASIC REQUIREMENT OF LICENSING AND REGISTRATION FOR STARTING A BUSINESS

REQUESTING AND REGISTERING AN EMPLOYER IDENTIFICATION NUMBER (EIN)

Except for sole proprietorships which do not employ anyone (other than the sole proprietor), every entity engaged in a trade or business in Puerto Rico must obtain a federal Employer Identification Number from the US Internal Revenue Service (IRS) by filing Form SS-4. Upon obtaining an EIN, the entity must file with the PR Department of Treasury a Form SC-4809, a copy of the certificate of incorporation and a copy of Form SS-4.

MERCHANT'S REGISTRATION CERTIFICATE

All merchants seeking to engage in a trade or business in Puerto Rico must register with the Puerto Rico Treasury Department Merchant Registry of Businesses at least 30 days prior to commencing business operations. The Certificate of Registration issued by the Treasury Department must be placed in a location at the trade or business which is visible to the general public.

A merchant may not transfer its Certificate of Registration or Certificate of Exemption unless the transfer is previously approved by the Secretary of the Treasury.

Any merchant who acquires taxable items for resale or any manufacturing plant may request a certificate of exemption of the sales and use tax. Every certificate of exemption is valid for three years. The exemption certificate is important because every merchant who has been issued this certificate will not have to pay sale tax when he/she purchases the items listed in the certificate.

COMPULSORY BUSINESS REGISTRY

All businesses operating in Puerto Rico must also register with the Compulsory Business Registry of the Puerto Rico Trade Company by 15 July of each year. Registration requires certain statistical information and can be done on the internet. Forms and information are available from the Puerto Rico Trade Company.

BIDDERS REGISTRY

Any person (natural or juridical) who wants to pursue business with any agency from the executive branch of the government of Puerto Rico is required to register with the Bidders Registry. This registry is administered by the General Services Administration (GSA) and it is through them that the application has to be filed. Requirements for entering the Bidders Registry include:

- An annual fee, which will depend if the application is filed by a corporation, individual, partnership, etc.
- A copy of the payment of municipal taxes
- A certificate which shows the payment of taxes in the Treasury Department of Puerto Rico
- Certain other documentation which varies according to the type of business/service.

INTERNAL REVENUE LICENCES

A licence from the Puerto Rico Treasury Department may be required to carry out certain activities, including:

- Selling cigarettes, gasoline, vehicles and parts and accessories of vehicles, jewellery, cement, arms and ammunitions

- Operating coin-operated machines
- Operating duty-free port stores
- Selling firearms and munitions
- Operating public carrier businesses.

Such licences may not be transferred without the authorization of the Puerto Rico Secretary of the Treasury. A manufacturer of articles whose sale requires a licence is not required to have such a licence, provided the manufacturing operations are completely apart from any location in which an activity subject to such a licence is conducted.

5 – LABOUR

WAGES

The United States Federal Fair Labour Standards Act (FLSA) applies in Puerto Rico.

Employers covered by the FLSA are subject only to the federal minimum wage and all applicable regulations. Employers not covered by this act are subject to a minimum wage which is at least 70% of the federal minimum wage, or the applicable mandatory decree rate, whichever is higher. The Secretary of Labour and Human Resources of Puerto Rico may authorise a rate based on a lower percentage for any employer who can show that implementation of the 70% rate would substantially curtail employment in that business.

The FLSA establishes the minimum wage, overtime pay, record keeping, and youth employment standards which affect employees in the private sector and in federal, state, and local governments. Covered non-exempt employees are entitled to a minimum wage of not less than USD 7.25 per hour effective 24 July 2009.

Puerto Rico also has minimum wage rates which vary according to the industry. These rates range from a minimum of USD 4.25 to USD 7.25 per hour.

UNEMPLOYMENT TAXES

FEDERAL UNEMPLOYMENT TAX

The provisions of the Federal Unemployment Tax Act (FUTA) apply in Puerto Rico as well as in the United States.

The tax is imposed on persons who employ one or more individuals for a portion of a day in each of 20 weeks in the current or preceding calendar year, or who pay in the aggregate USD 1,500 or more of wages in a calendar quarter of the current or preceding calendar year.

The FUTA tax rate for 2012 is 0.6% after a credit of 5.4% for the Puerto Rican unemployment tax on the first USD 7,000 of wages paid to an employee each calendar year.

The tax is deposited quarterly. Any excess is deposited with the last quarterly instalment along with the annual return Form 940-PR due on 31 January. The address to which the form should be filed depends on whether payment is included or not. When there is no payment, the return should be filed with Internal Revenue Service, P. O. Box 409101, Ogden, UT 84409. When payment is included, the form should be filed with the Internal Revenue Service, P.O. Box 105174, Atlanta GA 30348-5174.

The taxpayer can file and pay electronically by using electronic options available from the Internal Revenue Service.

PUERTO RICO UNEMPLOYMENT TAX

Each employer pays this tax on the first USD 7,000 of annual wages, based on an experience rating system.

In addition, every employer must pay a special tax of 1% of all taxable wages. However, the special tax, together with the experience-based tax, will not exceed 5.4% and may be credited against the Federal Unemployment tax mentioned above.

The total tax is paid by the employer and applies to every employer having one or more employees. The tax is paid quarterly on the last day of the calendar month following each calendar quarter. The cheque for payment of the tax should be made payable to the Secretary of the Treasury of Puerto Rico.

SOCIAL SECURITY

The provisions of the United States Federal Insurance Contributions Act (FICA) apply in Puerto Rico.

Under this act, both employers and employees are required to contribute to the Social Security Fund which was established to provide retirement benefits for all workers.

The tax rate is 7.65% for employers and 7.65% for employees. The percentages are comprised as follow:

	SOCIAL SECURITY	HOSPITAL INSURANCE
Employer	6.20%	1.45%
Employee	6.20%	1.45%

The maximum social security wage base for 2021 is USD 142,800 and the 1.45% for hospital insurance is computed on all wages regardless of amount.

Self-employed individuals are subject to the total 13.3% tax rate on net earnings from carrying on a trade or business.

DISABILITY BENEFIT TAX

The Disability Benefit Act provides benefit payments to employed workers who suffer the loss of wages as a result of incapacity to perform their customary work due to injury, illness or pregnancy.

This Act provides a tax of 0.60% on the first USD 9,000 of wages paid during the calendar year by an employer to an employee. Both the employer and employee share the tax evenly. An employer can set up a private plan to cover the benefits provided in this act.

Employers subject to the chauffer social security tax are not subject to this tax.

WORKMEN'S COMPENSATION

Workmen's compensation provides for indemnification for accidents incidental to or as a consequence of the employment. All employees of a business, including executive officers, are covered. The rate varies according to the type of labour performed by the employee. Rates are revised every year. The tax is entirely borne by the employer and is usually paid in two instalments.

WORKER BONUSES

CHRISTMAS BONUS

Employees hired before January 26, 2017

Each worker having worked at least 700 hours in the twelve-month period beginning October 1 and ending September 30 is eligible to receive a mandatory Christmas bonus. The bonus is 6% of the employee's wages up to a maximum employee individual wage of \$10,000. Accordingly, the maximum bonus payable will be \$600. In the case of those businesses with 15 or less workers, the applicable rate is 3% of the worker wages up to a maximum of \$10,000 (\$300).

Employees hired after January 26, 2017

Each worker having worked at least 1,350 hours in the twelve-month period beginning October 1 and ending September 30 is eligible to receive a mandatory Christmas bonus. In case, that the business employs 21 or more workers for 26 weeks within the coverage period, it will be required to pay to each worker a bonus equal to 2% of the total salary earned up to a maximum bonus of \$600.

In case of those businesses with 20 or less workers, the applicable rate is 2% up to a maximum bonus of \$300.

During the first year of employment, the applicable bonus for any worker will be the 50% of the above provisions.

The payment of Christmas bonus required by law should normally be made between November 15 and December 15 of the current year.

If the Christmas bonus does not exceed \$600, the business will not withhold taxes from bonus paid. When the Christmas bonus exceeds \$600 but does not exceed \$1,500, the employer must withhold a 7% tax from the total bonus. If the bonus exceeds \$1,500, the business may use the applicable withholding rules established on "Employer's Guide".

Christmas Bonus Exemption Request

Businesses may request an exemption from payment of the Christmas bonus if the total gross amount that would be payable to its workers exceeds 15% of its total net income during the same twelve-month period used to determine the eligible workers.

To apply for the exemption, a business must send a written notification to the Secretary of Labor and Human Resources indicating the reason for the exemption not later than November 30, 2020. The business must include original signed and sealed compiled, revised, or audited financial statements and their notes for the period from October 1, 2020 through September 30, 2021. If the company's fiscal year does not end on September 30, the employer may submit, in the alternative, financial statements corresponding to its fiscal year, and interim financial statements for the remaining period between the end of its fiscal year statements and September 30, 2021. The exemption request must be sent by mail.

If the business fails to submit the data to support non-payment of the bonus, it becomes liable for the payment of the full bonus.

If the business does not pay the bonus when due, the worker will be eligible to receive and additional bonus. It can be 50% or 100% of the amount of the bonus, depending on the date paid.

Businesses are required to notify terminated workers who are entitled to the bonus before payment due date and may request his/her mailing address to mail the bonus.

BONUS TO AGRICULTURAL WORKERS

The government of Puerto Rico pays this bonus until the agricultural industry is able to pay from its own funds. The farmer-employer only has to file certain reports.

A person working in the agricultural industry in Puerto Rico in the employ of a farmer is entitled to the bonus if:

- 1) He/she worked in Puerto Rico for not less 200 hours, or
- 2) He/she received wages and supplementary payments of not less than USD 200 for agricultural tasks performed in Puerto Rico, within the 12 months fiscal year ending 30 June.

The bonus is the greater of USD 165 or 4% of the annual income of the worker. The maximum amount of the bonus is USD 235.

6 – TAXATION

The major taxes imposed in Puerto Rico are income taxes, property taxes, municipal licence taxes, sales and use taxes, excise taxes and payroll taxes.

Entities doing business in Puerto Rico must comply with the requirements imposed by the different laws such as payments of tax, withholdings on certain payments and filing returns and reports with different government agencies.

INCOME TAX

Income tax is imposed on individuals and businesses.

INDIVIDUALS

The tax rate for an individual depends on whether he/she is a resident of Puerto Rico or not. For the year 2020, the ordinary taxable income of resident individuals is taxed at progressive rates ranging from 7% to 33% (on taxable income over USD 61,501).

Married individuals living together, filing a joint return and both working, may choose the optional computation of the tax to determine the tax individually.

Preferential rates are provided for capital gains, certain dividends and partnership's distributions, as well as for interests on certain obligations or deposits with organisations of banking nature. For determining the taxable income, the individual may claim the deductions and exemptions provided in the Puerto Rico Internal Revenue Code of 2010. For additional information please refer to Appendix I.

Non-residents are taxed only on their income from sources within Puerto Rico or on income effectively connected with the conduct of a trade or business within Puerto Rico. The tax rate for non-residents depends on the class of income and on whether or not the individual is engaged in trade or business in Puerto Rico.

PARTNERSHIPS

The tax rate will be calculated at each partner's level based on their share of the partnership net taxable income, and considering their other type of income, since partnerships are treated as pass-through entities.

However, since this new treatment was established due to the New Internal Revenue Code of 2011, as amended, existing partnerships before the approval of the law could elect to keep their previous election to be considered as a corporation for income tax purposes.

LIMITED LIABILITY COMPANIES

The tax rate will be calculated at each member's level based on their share of the LLC net taxable income, and considering their other type of income, since LLCs are treated as pass-through entities. LLCs have the power to elect, if they prefer, to be treated as a partnership or as a corporation for purposes of income tax.

However, in the case of LLCs which are treated as pass-through entities or are disregarded entities under the United States Internal Revenue Code of 1986 (as amended), or under any other jurisdiction, they will also be treated as pass-through entities for Puerto Rico income tax purposes and no other election will be available.

CORPORATIONS

All corporations whether domestic or foreign that are engaged in trade or business in Puerto Rico are subject to an income tax rate from 18.5% to 30% for “Normal Tax” and “Surtax” together known as the regular tax. The taxable income is determined after the allowable deductions and credits.

The rates for corporations and partnerships not organized under the laws of Puerto Rico depend on whether or not the entity is engaged in trade or business in Puerto Rico.

In addition, and as a general rule, each entity subject to this tax for the purpose of enabling the Secretary of the Treasury to determine the correct amount of income subject to the tax, shall keep permanent books of accounts or records as are sufficient to establish the amount of the gross income and the deductions, credits and other matters required to be shown in any return.

OTHER TAXES

PROPERTY TAX

As a general rule, property taxes are imposed on the assessed value of real and personal property. The real property tax is imposed on the value of the property as assessed by the Municipal Revenue Collection Centre. The tax is payable semi-annually on 1 July and 1 January each year.

The personal property tax is self-imposed upon the filing of a return by any natural or legal entity engaged in a Puerto Rico trade or business and which on 1 January owns personal property used in the trade or business. The tax rate depends on the place (municipality) in which the property is located.

For the taxable year 2019-2020, the personal property tax rates range from 5.80% to 10.33%. The real property tax rates are 2% higher.

MUNICIPAL LICENCE TAX

This tax is similar in nature to the gross receipts. It is imposed on all persons engaged in business based on the volume of business attributable to the corresponding municipality.

The tax rate is not the same in every municipality. For determining the applicable rate, businesses are grouped into two categories: financial and non-financial. Financial businesses are subject to a maximum rate of 1.5% of the volume of business. Non-financial businesses are imposed a maximum tax of 0.5% of the volume of business. The definition of the volume of business is different for financial and non-financial businesses.

In order to conduct operations free of this tax for the semester a business commenced operations, every person who commences any industry or business is obliged to notify the Municipal Treasurer within 30 days of commencement of operations.

SALES AND USE TAX

A sales and use tax is imposed on every sale of tangible personal property or taxable service, admission, use, storage or consumption in Puerto Rico, unless specifically exempted.

- The sales and use tax is 11.5% (10.5% for the Commonwealth of Puerto Rico and 1% for the municipalities). Generally, retail sales are taxable, but sales for resale and for export are exempt. The sales and use tax is paid by-monthly on or before the 15th and the last day of the current month. A reduced sale and use tax of 4% apply to designated professional services and services rendered to other merchants (Special SUT).
- In the sales and use tax area, the number of Puerto Rico merchants that will be required to collect the 4% Special SUT rate applicable to certain services will be substantially reduced with the increase in the existing threshold for collection from gross sales of US\$50,000 a year to \$300,000 year.
- Also, the rate applicable to prepared sold by restaurants will decrease from 11.5% to 7%, effective on October 1, 2019. To qualify, the business must comply with certain requirements.

EXCISE TAX

This tax is imposed only once on articles imported, sold, consumed, used or transferred in Puerto Rico. This tax is imposed on cement manufactured or introduced into Puerto Rico, sugar, plastic products, cigarettes, fuels, products derived from oil and hydrocarbon mixture, vehicles and on certain transactions. The tax rates are different for the different products.

Some other transactions are also subject to an excise tax. Included in these transactions are sales of jewellery, occupancy or rooms in hotels, public shows and horse racing winnings. The tax rate varies depending on the transaction.

PAYROLL TAX

A business operating in Puerto Rico must comply with the US Federal Insurances Contribution Act (FICA), the US Federal Unemployment Tax Act (FUTA), the Puerto Rico Unemployment and Disability Taxes Provisions, the Puerto Rico Chauffeur's Social Security, the Puerto Rico Workmen's Compensation Insurance and the Puerto Rico Christmas Bonus Act provisions.

ANNUAL REPORT

Every corporation is required to file an annual corporation report with the Puerto Rico Department of State. A USD 150 annual fee is payable when filing the report. In addition, the corporation must file a balance sheet certified by a CPA licensed in Puerto Rico when the volume of business exceeds USD 3MM.

In the case of foreign corporations authorized to do business in Puerto Rico, whose volume of business does not exceed USD 3MM, the annual report needs to be accompanied by a balance sheet of the Puerto Rico operations compiled and certified by a CPA licensed in Puerto Rico.

7 – ACCOUNTING & REPORTING

As in the United States, certified public accountant (CPA) firms which provide attest services are required to be registered with the Public Accounting Oversight Board.

This Board was created to provide registration, inspection, auditing standards, and enforcement for all CPA firms providing audits of publicly owned companies, including those listed in the US exchanges.

Puerto Rico retains 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.

All entities engaged in a trade or business or in the production of revenue 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”), along 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 \$10MM or more. AFS should be attached to the Volume of Business Declaration for municipal license tax purposes, annual report and personal property return when the volume of business is \$3MM or more.

An entity with a volume of business over \$1MM, 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 Alternative Minimum Tax or Alternative Basis Tax, as the case may be.

If the volume of business does not exceed \$3MM (or \$1MM, 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.

Each controlled group of corporations or group of related entities engaged in trade or business in Puerto Rico, must submit AFS for every entity within the group with a volume of business of \$1MM or more if the aggregate volume of the group is \$10MM or more.

Licences to engage in the practice of public accounting in Puerto Rico are issued by the Board of Accountancy to those holding a certificate showing them to be a certified public accountant and registering as a public accountant.

TRANSFER PRICING

Commencing for taxable year 2019 some taxpayers will be required to file a transfer pricing study together with their income tax return. A transfer pricing study is an analysis of the transactions among related entities and a comparison of those transactions with the results of similar transactions among unrelated parties to determine if the charges are arm's length.

Initially, these types of expenses were deductible up to 49% of the amount incurred and the remaining 51% resulted in a non-deductible tax adjustment. Before 2019, Puerto Rico Treasury allowed the request of a waiver from the application of this provision. Such waiver required the filing of a formal request, an Agreed Upon Procedures Report and a Transfer Pricing Study.

This process was long and costly, and also, Puerto Rico Treasury was slow in responding to these requests. For these reasons many taxpayers decided against requesting such waivers.

When, Act 257 was signed on December 2018 it simplified the process by establishing that in order to deduct the total amount of such expenses the taxpayer must file with the income tax return a Transfer Pricing Study including the Puerto Rico operations. This requirement is effective for years beginning after December 31, 2018. It is important to note that operations covered under a tax exemption grant are not subject to this requirement.

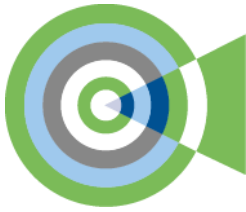
The transfer pricing study must follow U.S. transfer pricing regulations if the group has U.S. operations. If the group does not have U.S. operations, the transfer pricing study can follow OECD guidelines.

8 – UHY REPRESENTATION IN PUERTO RICO

PLEASE NOTE YOUR FIRM PROFILE WILL BE ADDED HERE.

PLEASE ENSURE IT IS UPDATED ON UHY EXCHANGE:

<https://intranet.uhy.com/secure/FirmProfile.aspx>



LET US HELP YOU ACHIEVE FURTHER BUSINESS SUCCESS

To find out how UHY can assist your business, contact any of our member firms. You can visit us online at www.uhy.com to find contact details for all of our offices, or email us at info@uhy.com for further information.

UHY is an international network of legally independent accounting and consultancy firms whose administrative entity is Urbach Hacker Young International Limited, a UK company. UHY is the brand name for the UHY international network. Services to clients are provided by member firms and not by Urbach Hacker Young International Limited. Neither Urbach Hacker Young International Limited, the UHY network, nor any member of UHY has any liability for services provided by other members.

UHY Del Valle & Nieves, PSC (the "Firm") is a member of Urbach Hacker Young International Limited, a UK company, and forms part of the international UHY network of legally independent accounting and consulting firms. UHY is the brand name for the UHY international network. The services described herein are provided by the Firm and not by UHY or any other member firm of UHY. Neither UHY nor any member of UHY has any liability for services provided by other members.

© 2019 UHY International Ltd