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**GOLDMAN ANTONETTI & CÓRDOVA, LLC
ESTABLISHING A BUSINESS ENTITY IN PUERTO
RICO**



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ESTABLISHING A BUSINESS ENTITY IN PUERTO RICO



“Establishing a Business Entity in Puerto Rico”

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Puerto Rico offers many advantages to individuals and companies that decide to establish business operations on the Island. These include unique local tax incentives; a strong, dedicated, and skilled bilingual labor force; legal protections afforded as a United States jurisdiction; vantage position as a Caribbean hub and a nexus between the United States, Latin America, and Europe; and highly developed industrial and commercial infrastructure. Fortune 500 companies have established operations in Puerto Rico for many of these reasons.

When starting a new business in Puerto Rico, whether as a new entity or through the expansion of an existing entity, there are many important decisions to be made. Local rules and procedures must be considered as a first step on the road to success. Issues such as financing, corporate structure and governance, tax structure, location selection, intellectual property protection, equipment acquisition, licensing and permitting, contracts, personnel recruitment and retention, and employee benefits are just some of the considerations that must be addressed by an emerging or expanding business. Other matters to assess include federal and local laws and regulations that may apply to particular lines of businesses. Companies interested in entering into governmental contracts must also consider additional requirements such as insurance coverage, bonds, warranties, and other financing provisions and requirements prior to the contract bid or execution. Businesses

performing certain activities may also need to consider particular statutes and regulations applicable to those activities.

1. Types of business organizations and entities available in Puerto Rico

The organization and maintenance of legal entities for engaging in commerce is generally governed by the Puerto Rico General Corporations Act of 2009, as amended (GCA). Puerto Rico's GCA was modeled after the General Corporations Law of the State of Delaware. Corporate elements such as corporate organization, capitalization, and governance requirements generally follow Delaware's corporate practice. The following forms of enterprise are the most common alternatives to establish and operated a business in Puerto Rico.

A. Sole Proprietorship

A sole proprietorship is a business whose assets are owned by a single individual and not by a separate legal entity. There are no special legal requirements for creating a sole proprietorship. Only one level of taxation applies: at the owner's level and at the owner's tax bracket. The principal disadvantage of this business form is that the sole proprietor will be personally liable for the debts and obligations of the business.

B. Traditional Partnership

Unlike other legal entities in Puerto Rico, the organization, governance, actions, obligations, and dissolution of a traditional partnership are governed by the Puerto Rico Civil Code. A partnership can be formed by two or more natural or legal persons that decide to bind themselves to conduct and operate a business as partners, with the intention of dividing the profits amongst themselves. Governance and capitalization of



the partnership hinge on the partnership agreement which constitutes the partnership itself. Generally, partners have equal interests in the partnership unless the agreement states otherwise. The partnership agreement should also provide details regarding the initial capitalization and provisions for opening the partnership to new partners. Note that although traditional partnerships are separate legal entities from its partners, the partners generally remain personally liable for the debts and obligations of the partnership. Partnerships are not subject to income tax at the partnership level but rather at the partner's level.

C. Limited Liability Partnership

Limited liability partnerships (LLPs) can be formed by at least two natural persons through the execution of a public deed form before a Puerto Rico notary public which must then be registered at the Puerto Rico Department of State. In general, the partners of an LLP benefit from limited liability exposure for the debts and obligations of the partnership, except for cases where the partner had personal knowledge and/or acted with willful misconduct. LLPs are subject to yearly renewal. Absence of a timely renewal may convert the LLP into communal property, and therefore expose the partners to unlimited liability. LLPs can offer all types of services, including professional services. If professional services are to be offered, all the partners of the LLP must have a license duly issued by the corresponding Puerto Rico instrumentality, and must also have professional liability insurance coverage. LLPs are taxed in the same manner as traditional partnerships.

D. Corporation

The corporation is one of the most commonly used business forms in Puerto Rico. As noted

before, the legal provisions for the organization and governance of a corporation in Puerto Rico mirror the Delaware corporate model, which is widely used in the United States. Puerto Rico corporations can be organized for-profit and not-for-profit purposes. A corporation is a separate legal entity independent from its shareholders, whose personal responsibility for the debts and obligations of the corporation are limited to their capital contribution. Corporations' income is subject to taxation at two levels: the corporation is taxed at the corporate level on their net income while the shareholders are subject to income tax at their personal level on dividends distributions received from the corporation. In general, corporations are governed by a board of directors, with appointed officers managing daily business operations. Corporations are subject to strict corporate governance compliance requirements. A not-for-profit corporation can be organized by one or more members and could qualify for tax exemption.

E. Professional Service Corporation

A professional service corporation (PSC) is an entity that can be formed by one or more shareholders, whose business is limited to render a professional service. Under the GCA, professional services are defined as services for which a professional license is required, such as certified public accountants or attorneys-at-law. All shareholders and officers in a PSC must be licensed to render the same professional service in Puerto Rico. PSCs are subject to the same general corporate governance rules as regular corporations. As in corporations, the shareholders of PSCs benefit from limited liability, except when professional liability, negligence, or willful misconduct has been proven to have occurred while they are



rendering the service. PSCs are also subject to taxation at two levels in the same manner as regular corporations.

F. Limited Liability Company

Limited liability companies (LLCs) comprise the most recent alternative available to individuals who wish to engage in business in Puerto Rico. In essence, LLCs are a hybrid between a partnership and a corporation. LLCs are constituted by members, rather than shareholders, who own an interest in the entity instead of shares. LLCs can be formed by one or more members (who can be natural or legal persons). The constitutional document of an LLC is its operating agreement. The LLC operating agreement provides for the company's governance, capitalization requirements and the purchase or sale of company interests. Puerto Rico law provides members with a wide degree of freedom to decide on an LLC's governance and structure. Internally, LLCs can operate as a partnership or as a corporation, or as a combination of both. As opposed to corporations, LLCs are not required to file annual reports although payment of an annual fee is required. While LLCs are subject to taxation at two levels in the same manner as regular corporations by default, they can elect to be treated as partnerships for tax purposes. Note that partnership tax treatment will be mandatory in certain circumstances. LLCs can be organized for profit and not-for-profit businesses. LLCs can be also organized to render professional services, subject to most of the limitations of the PSCs.

2. Brief overview of steps to incorporate/constitute each type of entity

A. Basic requirements

The permitting requirements for businesses establishing operations in Puerto Rico vary, depending on the particular operations in question and the company's needs and growth expectations, among others. The basic federal and local permits, authorizations, or licenses required for most businesses include:

1. **Business Authorization:** Most entities (corporations, LLCs and LLPs) must register with the Puerto Rico State Department before commencing operations. We recommend ensuring the availability of a desired corporate name prior to registration with the Corporations Registry, an office within the Puerto Rico Department of State. All legal entities registered with the State Department have annual reporting and/or annual fee obligations. Most of these filings and fee payments are due on or before April 15.
2. **Federal Employer Identification Number:** New businesses must apply for an employer identification number (EIN) with the U.S. Internal Revenue Service (IRS). The EIN is used for federal and local tax purposes, including Medicare and Social Security taxes as well as Puerto Rico income taxes.
3. **Puerto Rico Department of Treasury Notification:** The EIN must be notified to the Puerto Rico Department of Treasury (PRDT) along with copy of the certificate of incorporation. Businesses seeking to engage in trade or commerce in Puerto Rico must register with the PRDT Registry of Business at least 30 days prior to commencing operations.



4. **Municipal License Tax (Patente Municipal, as it is commonly referred to in Spanish):** Puerto Rico law allows municipalities to impose and collect municipal license taxes based on the volume of business of up to 0.5 percent of gross receipts. Entities and individuals that establish businesses in Puerto Rico must apply for a municipal business license in the corresponding municipality within 30 days of commencing operations. Upon compliance with the municipality's requirements, the Company will obtain a provisional license, which exempts the company from paying tax during the first semester of operation (note that semesters are based on the government's fiscal year — July 1 through December 31 or January 1 through June 30). Please find additional detail in the Tax Overview section below.
5. **Unemployment and Disability Identification Number:** Businesses must obtain an unemployment and disability account number assigned by the Puerto Rico Labor and Human Resources Department (PRDOL), which administers unemployment insurance. Temporary disability insurance may be obtained privately; proof of such insurance must be filed with the PRDOL. This requirement may also be met by obtaining coverage from the Puerto Rico Non-Occupational Disability Insurance Bureau ("SINOT" for its Spanish acronym.)
6. **Worker's Compensation Fund:** All employers are required by law to purchase a workers' compensation insurance policy issued by the State Insurance Fund Corporation. Insurance premiums vary in accordance with the level of risk assigned to the various categories of employees. Employers with active policy coverage have absolute immunity from civil liability stemming from employees' occupational accidents or illnesses, unless when intentionally caused by the employer.
7. **Sales and Use Tax Registration:** Puerto Rico law imposes a sales and use tax on the sale of taxable goods and services. Accordingly, all persons conducting business in Puerto Rico must register as a merchant with the Puerto Rico Treasury Department 30 days prior to commencing operations. A separate registration with the local municipality may also be required, depending on the municipality in which the company will establish its business. Once registered, businesses will be required to file a return and remit any tax collected on or before the tenth day of every month.
8. **Bidders' Registry:** All natural persons or legal entities who wish to provide goods and/or nonprofessional services to the executive agencies and public corporations of the Commonwealth of Puerto Rico, excluding the Public Private Partnership Authority, the Office of Government Ethics, the Puerto Rico Institute of Culture, the University of Puerto Rico, the Planning Board, and the State Election Commission, must register with the General Services Administration's "Registro Unico de Licitadores." After registration, each prospective bidder must obtain a Certificate of Eligibility. All applicable executive agencies and public corporations of the Government of Puerto Rico must use and verify the qualifications of the bidders before awarding bids for the purchase of goods or entering into contracts for any such services.



Also, some Puerto Rico government agencies and instrumentalities might have, by regulation, additional bidders' filing requirements. It is important to verify the prospect entity before submitting the GSA Certificate of Eligibility to comply with any additional agency requirements.

9. Manufacturer's Excise Tax Identification

Number: The Excise Tax Act provides tax exemption for raw materials and machinery and equipment used in manufacturing plants. Companies seeking to benefit from such exemption must obtain a Manufacturer's Excise Tax Identification Number from the Excise Tax Bureau to take raw materials at ports of entry and to prove exemption status.

10. Construction and Use Permit: Puerto Rico law requires businesses to be located in areas which are zoned for the intended use. Constructing or expanding existing structures to accommodate a business may require a construction permit by the Office of Permits Management or the Municipal Permits Office. Permits are also required before occupying a building and using it as intended. Use permit applications must be filed with other Commonwealth of Puerto Rico agencies' endorsements or certifications.

11. Chauffeurs' Insurance Employer Account Number and Notice of Employee Entry:

Entities must obtain a Chauffeurs' Insurance Employer account number and file notices for employees who drive motor vehicles in the ordinary course of employment before the Chauffeurs' Social Security Bureau of the Department of Labor and Human Resources.

Please note that businesses may be required to obtain additional permits, authorizations,

and licenses in accordance with other federal or local laws and regulations which may be applicable to their particular operations. These may pertain to such areas as environmental and natural resources protection, land use, infrastructure, health and safety, building approvals, fire prevention and worker protection, among others.

B. Compulsory Registration of Foreign Entities

The GCA establishes that foreign corporations may not engage in commerce or conduct business in Puerto Rico without previously receiving an authorization to do business from the Puerto Rico Department of State.

The main penalty imposed by the GCA on unauthorized foreign corporations is a general prohibition to seek redress for damages or commence any legal proceeding at local courts. However, unauthorized foreign corporations may be sued in the local courts and they may defend themselves from any such complaints.

The GCA provides a non-exhaustive list of activities that are not considered "doing business" for purposes of the mandatory registration of foreign corporations discussed above. The following activities are specifically considered "non-constitutive" activities for the purposes of the Corporations Act:

- Initiate, defend, or settle any judicial process.
- Conduct meetings of the Board of Directors or stockholders or other activities related to internal corporate affairs.
- Maintain bank accounts.
- Keep offices or agencies for the transfer, exchange, and registration of the corporation's own securities or keep



trustees or depositories with respect to such securities.

- Sell through independent contractors.
- Solicit or obtain orders, whether by mail or by employees or agents or otherwise, if such orders are to be accepted outside of the Commonwealth before a contractual obligation arises.
- Create or acquire debts, mortgages, or personal and real property securities.
- Guaranty or collect debts or foreclose on mortgages or securities on the properties which guaranty such debts.
- Own title to personal or real property.
- Conduct an isolated transaction which is completed within a period of thirty (30) days and which is not part of a series of similar nature.

The need to register and the exceptions to the registration also apply to limited liabilities companies.

3. REGULATION AND ONGOING MAINTENANCE

A. Reporting Requirements

Annual Reports: All corporations (domestic and foreign) as well as professional corporations must file a yearly annual report with the Puerto Rico Department of State, no later than April 15 of the year. Filing fees for annual reports are \$150.00 for for-profit corporations and \$5.00 for non-profit corporations.

Annual Dues: LLCs only need to pay an annual fee on or before April 15 of each year. The annual fee for the limited liability company is \$150.00.

Failure to submit the Annual Report or pay the Annual Fees entails the imposition of

penalties and possibly the cancellation of the legal entity.

B. Special Regulations and Requirements to Conduct Business

Consumer Protection Laws and Regulations: The Department of Consumer Affairs (“DACO”, for its Spanish acronym) is a governmental consumer advocacy agency which advises consumers regarding their rights. DACO also has enforcement authority and is allowed to impose fines and penalties as provided by law. DACO also restrains inflationary trends and implements and monitors price controls over goods and services. To achieve its objectives, DACO has promulgated a series of regulations covering such different areas of consumer interest and protection such as:

- Misleading practices in advertising
- Contests and sweepstakes
- “Rain checks”
- In-store pricing labels and other required store signage
- Automobile warranties
- Real estate brokerage
- Residential real estate development
- New condominium registrations
- Condominium Law violations
- Construction defects and other construction-related services
- Gasoline retail prices
- Cement quality controls
- Real property contractor registration
- Collection agencies

Almost any complaint that a consumer may have against a retailer, service provider or any other type of business establishment that serves the public can be presented to DACO



for review. DACO has the authority to hold administrative hearings and to issue rulings against businesses and may inspect businesses and establishments in Puerto Rico as part of its standard regulatory enforcement procedures. DACO is also authorized to impose fines, which can currently reach up to \$10,000 per infraction, and may also refer certain violations for criminal action.

It should be noted that all DACO laws and regulations are subject to periodic amendments and changes.

The Dealer' and Sales Representatives' Contracts Acts: The Dealer's Contract Act, Act 75 of June 24, 1964, as amended (commonly referred to as "Act 75"), is aimed at protecting the interests of dealers or distributors, whether they are exclusive or not, operating in Puerto Rico from the harm caused when a principal or supplier arbitrarily terminates or impairs a distributorship.

An offspring of the Dealer's Contract Act, the Sales Representatives' Contract Act, was enacted as Act 21 of December 5, 1990. Act 21 protects only exclusive sales representatives — who normally assume all the operational costs which such representation entails, such as the cost of maintaining an office, exhibition rooms, vehicles, office personnel, phones, power, water, insurance, travel costs, representation costs, office supplies, and municipal patents from termination or impairment without just cause.

Under either Act 75 or Act 21, the contract may not be terminated, or have its renewal withheld or impaired without just cause. The "established relationship" between the parties is governed by the agreement. Therefore, such laws normally only protect against detriments to contractually acquired

rights of the relationship derived from a dealer's or sales representative's contract with few exceptions. However, the laws require just cause to impair, terminate or refuse to renew regardless of any contract clause establishing a fixed term or allowing impairment, termination or non-renewal other than for just cause. The term 'just cause' is explicitly defined by both laws.

Bank Activities: Puerto Rico does not have a central bank and thus forms part of and is regulated by the Federal Reserve System. Local as well as foreign banks (by means of branches or representative offices) must obtain a license from the Commissioner of Financial Institutions before starting operations. The Puerto Rico Office of the Financial Institutions Commissioner controls, supervises and regulates the interest rates and maximum fees applicable to any given financial transaction, unless otherwise specified in special legislation.

Securities Activities: The U.S. Securities and Exchange Commission (SEC) controls the purchase and sale of securities in the U.S. markets. For purposes of the SEC, Puerto Rico is considered part of the U.S. market. Since Puerto Rico does not have a local securities exchange market, generally all purchases and sales of securities in Puerto Rico are done in the U.S. markets. In addition, the Commissioner of Financial Institutions regulates financial activities in Puerto Rico at a local level. Therefore, certain public issuances of bonds or preferred stocks, among others, must be registered with the Commissioner of Financial Institutions to be marketed and sold in Puerto Rico.

Insurance Activities: The insurance industry is subject to the provisions of the Puerto Rico Insurance Code and the rules and regulations



promulgated by the Puerto Rico Office of the Commissioner of Insurance.

Notary Public: The notary public in Puerto Rico follows civil law traditions, which are different from the common law notary public. The main difference between a notary public in Puerto Rico and most stateside counterparts is that a notary public in Puerto Rico will always be a licensed attorney (all notaries are licensed attorneys; not all attorneys are notaries). As such, a notary public receives, interprets, and provides legal form to parties' wills, usually through the execution of a public deed. Public deeds are generally required for the transfer of real estate, effecting powers-of-attorney and executing private wills. The notary also authenticates the identity of a signatory as well as the date of execution of a given document. Both notarial functions must be regularly notified to corresponding registers. By law, most notarial fees are fixed.

Environmental Matters: Environmental requirements for businesses establishing operations in Puerto Rico depend on the activities undertaken by the company. Generally, there are federal and Puerto Rico statutory and regulatory requirements requiring that environmental permits be obtained and/or the registration of certain activities. A number of processes and operations subject to medium-specific federal programs, such as the Clean Air Act, Clean Water Act, Resource Conservation and Recovery Act, Toxic Substance Control Act, Oil Pollution Act, and the Emergency Planning and Community Right to Know Act also apply in Puerto Rico. Other federal requirements stem from the Federal Insecticide, Fungicide and Rodenticide Act and the Food and Drug Act, among others. Commercial operations often require the preparation and implementation of a Recycling Plan, the

appropriate permits for the construction and operation of emergency generators, sanitary license, and certificate and permit for fire prevention.

a. Other considerations

a. Free Trade Zone

Puerto Rico has a very close relationship with the United States while conserving certain fiscal independence. This is particularly evident when discussing Puerto Rico's "free trade zones." A free trade zone offers a business a unique opportunity to establish its operations in an area with lower trade barriers and fewer bureaucratic requirements.

As a rule, imports and exports to and from Puerto Rico are subject to customs and tariff regulations issued by the United States. The Federal Foreign Trade Zone Act allows merchandise to enter and leave free trade zones in Puerto Rico without being subject to the customs laws of the United States. While in a free trade zone, a business may handle the merchandise as provided by the federal statute, and subsequently export it outside the zone with little or no customs impact. This also includes the manufacture of certain goods in the free trade zone.

Many businesses have taken advantage of the Puerto Rico free trade zones, allowing them to move merchandise between free trade zones with no customs impact. This translates into lower operational costs, resulting in increased business revenues.

b. Labor and Employment

Puerto Rico is subject to all federal laws unless specifically deemed otherwise due to geographic or public policy considerations. Hence, labor and



employment statutes applicable in the 50 U.S. states and the District of Columbia are almost always applicable and enforced in Puerto Rico. Local statutes enhance or supplement federal employment law, and sometimes offer other protections not provided by federal law. Puerto Rico departs from the employment at will standard in that employees are provided multiple safeguards in terms of the legal and monetary ramifications in cases involving wrongful termination. In particular, the law provides severance pay based on years of employment for employees terminated without just cause.

Some of the U.S. federal laws applicable in Puerto Rico in the labor and employment context are: The Fair Labor Standards Act (FLSA); the Employee Retirement Income Security Act (ERISA); the National Labor Relations Act (NLRA); the Consolidated Omnibus Budget Reconciliation Act (COBRA); the Family and Medical Leave Act (FMLA); the Americans with Disabilities Act (ADA); and the Uniformed Services Employment and Reemployment Rights Act (USERRA); among others.

The following is a summary of the most relevant local labor and employment statutes applicable to workers in Puerto Rico:

Working Hours: The maximum working period per day shall not exceed eight hours. Local law provides greater protections than the federal counterpart with respect to the payment of overtime for time worked after eight hours per day and/or for time worked more than 40 hours in the work week.

Maternity Leave and Benefits: Local law grants pregnant employees the right to enjoy maternity leave. The rights, protections, and benefits afforded by law apply to pregnant employees that are working, enjoying regular vacation or on sick leave, or are under any other type of special leave or rest authorized by law while the employment relationship is in effect. During pregnancy, working women are entitled to a fully paid rest period of four weeks before childbirth and four weeks after childbirth. In Puerto Rico, it is illegal to dismiss, lay-off, reduce the salary, or discriminate in any manner against a female worker due to a reduction in her work productivity while she is pregnant. The employee is entitled by law to reinstatement and double damages for any violation.

Christmas Bonus: As of January 27, 2017, Employers that employ 20 or more workers within the 12-month period comprised from October 1 of any calendar year until September 30 of the subsequent calendar year must pay each employee that has worked 1350 or more hours during said period, an annual Christmas bonus. Special provisions apply to employers with less than 20 employees and/or those who are experiencing economic hardship.

Discharges: The general rule in Puerto Rico is that any employee in commerce, industry or any other business that has been hired without a fixed term of employment can be discharged for just cause, without cause, or even for an unjust cause. However, Commonwealth of Puerto Rico law provides for a mandatory severance payment to any employee hired without a fixed term who is discharged from his employment without



just cause or for an unjust cause. A breach of contract action may be brought by any employee hired for a fixed term.

It is therefore indispensable that reasonable written work rules of discipline and performance be published by the employer, and a copy of such rules is given to the employees for a discharge made pursuant to such rules to be considered as one for “just cause” within the meaning of the law.

Discrimination: Payment of substantial compensation may be imposed upon employers that are found to engage in the following activities: the discharge, lay-off or discrimination against an employee regarding his/her salary, wage, pay or remuneration, terms, rank, working conditions, or work privileges; or, failing or refusing to hire or rehire a person, or limiting or classifying its employees in any manner which tends to deprive a person of employment opportunities, or to affect her/his status as an employee, on the basis of age, race, color, gender, sexual orientation, status as a victim of domestic abuse, social or national origin, social position, marital status, political or religious beliefs of the employee or applicant for employment.

Sexual Harassment: Puerto Rico law prohibits sexual harassment in the workplace towards any employee and imposes severe monetary liability on any person or employer responsible of sexual harassment as defined in the law.

Discrimination against the Disabled: The Commonwealth of Puerto Rico also prohibits discrimination by government contractors and employers with 15 or more employees against individuals with disabilities. Employers must make

reasonable accommodation for the limitations of disabled individuals, unless said accommodation constitutes “an undue hardship in economic terms to the enterprise.”

Veterans: Puerto Ricans can voluntarily serve in all branches of the U.S. armed forces. Puerto Rico law imposes upon the employer the obligation to reinstate a veteran to his former job, provided he petitions for it within a period of six months after his dismissal or discharge from the armed forces.

Minimum Wage: The Federal minimum wage, which is currently \$7.25 p/h, applies to employers that are subject to the FLSA.

Labor Transformation and Flexibility Act: The Labor Transformation and Flexibility Act (LTFA) of January 2017 substantially amended Puerto Rico employment laws, modified employment agreements and change compensation and benefits to create a more competitive employment environment. Some of these changes include a reduction in vacation and sick leave accrual rate for new employees; increase in working requirements to accrue employment benefits; automatic and substantial increase to probationary periods; reduction in overtime rate; reduced mandatory Christmas bonus; reduction in statute of limitations and civil liability exposure for employers, among others.

c. Immigration Overview

Puerto Rico is subject to the U.S. Immigration and Nationality Act, as amended (INA), and Puerto Ricans are U.S. citizens by birth. Unlike other federal statutes, there are no exceptions with respect to Puerto Rico in the INA.



Therefore, only the following individuals may legally engage in employment in Puerto Rico: (1) citizens of the United States of America; (2) legal permanent residents; and (3) temporary foreign workers specifically authorized by the U.S. Department of Homeland Security through its U.S. Citizenship and Immigration Services and the Department of State through the National Visa Center.

The employment of foreign specialized professionals, including mid- and high-level managers and executives is usually allowed by the federal government. Recruitment of unskilled and skilled labor, as well as first-line supervisors is usually more difficult. A special arrangement exists for individuals of the following countries: Canada, Mexico, Chile, Australia, and Singapore.

d. Tax Overview

In general, Puerto Rico residents and corporations organized under the laws of Puerto Rico (“PR Domestic Corporations”) are subject to Puerto Rico income tax on all their income from whatever sources derived. Furthermore, since PR Domestic Corporations are considered “foreign corporations” under the U.S. Internal Revenue Code, they are, in general, only subject to U.S. taxation to the extent that they derive any U.S. source income.

Similarly, foreign corporations engaged in trade or commerce in Puerto Rico (“Resident Foreign Corporations”) are also subject to Puerto Rico taxes, but limited to their Puerto Rico source income and its income effectively connected with the conduct of a trade or business within Puerto Rico. Furthermore, a Resident Foreign Corporation deriving less than 80% of its gross income from Puerto Rico

will be subject to the Branch Profit Tax (BPT). The BPT is imposed on foreign entities doing business in Puerto Rico at a rate of 10% on accumulated profits treated under the law as a dividend or profits equivalent amount.

1. Income Taxation

Currently, there are two types of corporate income tax imposed under the Puerto Rico Internal Revenue Code of 2011, as amended (“PR Code”):

- a regular corporate tax, which is imposed on the net taxable income of the corporation or LLC that is taxed as a corporation; and
- an alternative minimum tax (AMT), which is imposed on the alternative minimum net income (AMNI) of the corporation.

The corporation’s net taxable income is generally imposed on its gross income less the deductions allowed under the PR Code. Such net taxable income is subject to a normal tax of 20% plus a surtax that ranges from 5% to 19% on its surtax net income.

2. Alternative Minimum Tax

i. In General

In addition to the regular tax, corporations may be subject to the AMT. The AMT due in such cases would be the excess, if any, of the tentative minimum tax over the regular tax. Currently, the tentative minimum tax is composed of:

- 30% of the AMNI over the “exemption amount,” reduced by the AMT foreign tax credit for the taxable year.

For purposes of AMT, the AMNI is computed in the same manner



applicable in the computation of the regular tax, except for certain adjustments.

3. Municipal License Tax (“Patente”)

Every person, natural or legal, engaged for profit in the rendering of any service, in the sale of goods, in any financial business or in any industry or business in Puerto Rico is subject, with limited exceptions, to the payment of the Municipal License Tax. This municipal tax is imposed on the taxpayer’s gross income.

The Municipal License Tax imposed on persons engaged in the rendering of a service, the sale of goods, or any other industry or business (other than a financial business) may not exceed 5/10 of 1% (0.5%) of the volume of business realized by that person in the corresponding municipality. Volume of business, for this purpose, means the gross income received or earned in the municipality where the main organization carries out its operations or the gross income received or earned where it maintains offices, warehouses, branches, or otherwise conducts business. Accordingly, the tax must be paid to the municipality where the main organization is located, unless the gross income is received or earned in a different municipality through offices, branches, warehouses or any other commercial organization in that municipality.

4. Personal property taxes

i. In General

All tangible personal property, owned by an individual or a legal entity and used in a trade or business, having taxable situs in Puerto Rico is taxable unless specifically exempt. “Personal

property” or “movable property” includes essentially all things other than real estate that have any pecuniary value. Such property is assessed as of its status and condition on the first day of January of each year. In other words, taxpayers are subject to the personal property tax on all property it owns as of the first day of January of each year, except for inventory as discussed below.

With respect to personal property, every person must file a personal property tax return that requires that person to value the property, and assess and pay the tax, based on the book value of the property. Book value, for these purposes, is the acquisition or production cost of the asset, adjusted for depreciation, obsolescence or other factors as reflected in the books of the company in accordance with generally accepted accounting principles. When the book value is minimal, however, the assessed value is the estimated residual value of the property as defined by law. Residual value is a percentage of the actual cost of the property, which percentage ranges from 10% to 20%, depending on the remaining life of the asset.

ii. Inventories

A principal exception to the use of January 1 as the valuation date for property tax assessment is the valuation of inventory. Inventory is valued and assessed based on the annual average inventory value during the calendar year immediately preceding the January 1 assessment date. For appraisal purposes, the inventory appraisal method known as



“LIFO” (last-in/first-out) is not an acceptable accounting method.

iii. Personal Property Tax Rates for Municipalities

Personal property tax rates are generally 2.00% less than the corresponding real property tax rate for each municipality. The personal property tax rates vary from municipality to municipality. For fiscal year 2016-2017, the personal property tax rates range from as low as 5.80% to as high as 9.83%.

e. Tax Incentives

Puerto Rico offers attractive tax incentives to businesses wishing to establish operations in the Island. The Economic Incentives Act for the Development of Puerto Rico (“Tax Incentives Act of 2008”) continues the historical line of local government incentives for investment in Puerto Rico. The Tax Incentives Act of 2008 reduces the income tax rates for eligible businesses to 4% (in some cases to 0% income tax). No tax is imposed on corporate distributions to shareholders. Exempt businesses also receive substantial tax exemption for other local taxes, such as a 90% exemption on property taxes and a 60% exemption on local municipal taxes. Other tax incentives acts, such as the Green Energy Incentives Act of Puerto Rico and the Puerto Rico Tourism Development Act, also provide similar tax benefits. Furthermore, tax incentives are also available for the operation of hospitals and bona fide agricultural businesses within Puerto Rico.

In addition to reduced rates, exempt businesses may qualify for substantial tax credits on certain investments. Many of these credits may be sold to third parties.

These tax credits apply to eligible investments made in energy efficiency, strategic construction projects, tourism projects, acquisition of machinery and equipment, and research and development, among others.

f. Special Tax Incentives to companies and individuals relocating to Puerto Rico – Acts 20 and 22

Act to Promote the Export of Services, Act No. 20 of January 17, 2012, as amended (Act 20), also offers tax incentives for the export of services from Puerto Rico. Puerto Rico’s geographic location and bilingual workforce, coupled with lower tax rates for businesses that export services, make the Island particularly attractive for businesses looking to set up headquarters for the eventual export of services to other markets in Latin America and the rest of the world. Tax benefits under Act 20-2012 are like those granted under the Tax Incentives Act of 2008: (1) 4% flat income tax rate; (2) 0% tax on distributions to shareholders; (3) 90% exemption on property taxes; and (4) 60% exemption on municipal taxes.

Finally, the Act to Promote the Relocation of Individual Investors to Puerto Rico, Act No. 22 of January 17, 2012, as amended (Act 22), looks to promote the relocation of investors that are non-residents of Puerto Rico by providing Puerto Rico income tax exemption on all passive income earned or accrued after becoming Puerto Rico bona fide residents, as well as capital gains in certain cases. Pursuant to Act 22, interest and dividend income from all sources that is earned by the individual after becoming a Puerto Rico resident is exempt from Puerto Rico income taxes (including the alternative minimum tax).



In the case of capital gains, during the first 10 years of residency in Puerto Rico, Act 22 states that the income tax rate applicable for the tax year in which the gain is realized will apply on long-term capital gains accrued and unrealized that are attributable to the increase in value of the securities before the individual becomes a Puerto Rico resident. However, after said 10-year period, a reduced 5% income tax rate will apply to such long-term capital gains that are recognized before January 1, 2036.

On the other hand, Act 22 states that both short and long-term capital gains accrued after the individual becomes a Puerto Rico resident and that are recognized before January 1, 2036, will be fully exempt from Puerto Rico income taxes. In the case of securities acquired by the individual before becoming a Puerto Rico resident, the total exemption applies only to the extent that the short or long-term capital gain is attributable to the increase in value of the securities after the individual becomes a Puerto Rico resident.