



GUIDE

Puerto Rico Act 20

Puerto Rico Tax Compliance Guide

*By Torres CPA Group
CifrasPR Puerto Rico*

Understanding the Puerto Rico tax system and its interrelation with United States is crucial for individuals and entities doing business in Puerto Rico. Puerto Rico is not a state; it's a territory, with its own Business and Payroll laws and regulations.

The following White Paper is designed to give an insight Tax Issues in Puerto Rico. It provides relevant background information, which will be of assistance to organizations considering establishing business in the Island. Nonetheless, it is highly recommended to seek advice and counsel from qualified professional sources before undertaking any business.

Certain exclusions and exemptions may apply and when specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico, and to obtain appropriate accounting and legal advice.

It is understood that the following overview does not constitute any formal rendering of either legal, accounting, tax or professional services. If legal advice or other assistance is required, an attorney, CPA or tax adviser should be consulted.

Torres CPA Group is an Advice Certified Public Accounting Firm offering Audit, Tax, Consulting and Financial Outsourcing services for over 33 years. If you require any further information or help, please do not hesitate to contact us.

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OVERVIEW OF PUERTO RICO ACT 20 TAX INCENTIVES

On January 17, 2012, the Legislature of Puerto Rico approved the Puerto Rico Act 20 Tax Incentives Law. This new legislation's objective is to promote the economic development of Puerto Rico through a series of tax incentives: (i) Act 20 to Promote the Exportation of Services (the "Export Services Act") and (ii) Act 22 to Promote the Relocation of Individual Investors to Puerto Rico (the "Individual Investors Act").

Puerto Rico operates as a Foreign Tax Structure, where federal income taxes do not apply. It works under a Controlled Foreign Corporation (CFCs) tax treatment; in which federal income taxes differ until repatriation of profits occurs.

Every tax incentive granted constitutes a contract with the government of Puerto Rico that is legally guaranteed and protected by United States law and will be unaffected by any future legislation.

PURPOSE

Puerto Rico has created an aggressive incentive program to connect with the global economy in order establish an ever-growing array of service industries, and to establish Puerto Rico as an international service center hub.

Puerto Rico seeks to attract outside service entities through tax incentives that encourage investors to relocate to the Island for purposes of stimulating economic growth and social improvement.

Puerto Rico's Act 20 also seeks to encourage local service providers to expand their services to persons outside Puerto Rico; and promote the development of new businesses in Puerto Rico.

TAX INCENTIVES

- 4% Fixed Income Tax Rate on income related to export of services or goods
- 0% US Federal Income Tax
- 100% Tax Exemption on Income Tax Rate from dividends or profit distributions
- 100% Tax exemption on Excise Tax and Sales and Use Tax
- 100% Real Property Taxes
- 60% Tax exemption on Municipal License Taxes
- 20-year Tax Government Decree, renewable for an additional ten year period
- 100% Property Tax exemption for the first five years of operation for certain export services, including corporate headquarters, call centers, shared service centers for accounting, finance, marketing, human resources, and other centralized management services. After the 5-year period expires, a 90% tax exemption will apply for the remainder of the Tax Exemption Decree.

In the case of service promoters, only the net income derived from Eligible Services performed within the 12-month period ending on the day preceding the day the new business.

ELIGIBILITY

Act 20 applies to any entity with a bona fide establishment in Puerto Rico that is engaged in an eligible service for export. Available services include, but are not limited to:

- Trading Hub
- Medical and Research
- Research and development
- Creative Services
- Advertising and public relations Commercial arts and graphic services Marketing
- Consulting & Advisory Services
- Economic Environmental Technological Scientific Management, Marketing

- Human resources Information and Audit consulting
- Consulting on matters relating to any trade or business Educational and training services
- Architectural and Engineering
- The production of construction drawing
- Service Centers
- Centralized management services Corporate headquarters
- Electronic data processing centers Development of computer programs
- Call centers voice and data telecommunications between persons located outside of Puerto Rico; shared service centers ("shared services") including but not limited to, accounting, finance, taxes, auditing, marketing, engineering, quality control, human resources, communications, electronic data processing and other centralized management services
- Hospital and Laboratory Services
- Distribution and Logistics
- Storage and distributions centers ("hubs")
- Financial Services
- Investment banking and Other financial services

An Eligible Service must qualify as either a service for exportation or a promoter service. Services for exportation are services performed for non-resident individuals and foreign entities that have no nexus with Puerto Rico which means that the Eligible Service is not, and will not be, related to the conduct of trade, business or other activity in Puerto Rico.

Promoter services are services rendered to non-residents individuals and foreign entities related to the establishment of a new business in Puerto Rico, as defined by the Export Services Act.

TAX EXEMPTION DECREE

An eligible service provider is required to obtain a Tax Exemption Decree that will endure for a term of 20 years and may be renewed for an additional ten years. The Tax Exemption Decree constitutes a contract between the service provider and the Government of Puerto Rico and will be unaffected by any future legislation.

EMPLOYMENT REQUIREMENT

Please note that Act 20 was recently amended, and any new business applying for Act 20 must comply with a minimum of five (5) full-time employees (FTE) for the period of the grant, for which the company should be in compliance before the end of the 6th month after starting its operation. FTE are employees who work 2,080 hours a year, including paid-time-off. 5 FTE is equal to 10,400 hours. If the company needs to recruit part-time employees, in order to qualify for this requirement, he/she must at least work 1,040 hours or more; or 50% of the time or more.

APPLICATION

In general terms, the Puerto Rico Act 20 tax incentive application requires the following documents:

- Business plan / Eligible Services Description – in essence, a detailed description of what the company will provide. (We can help prepare a detailed business plan.)
- Financial Projections – detailing not only the pro forma revenues, but expenses in detail, specifically payroll and employment generation
- Curriculum vitae – resume of the all shareholders
- Organizational chart – describing the corporate governance and structure
- Shareholder background check – for each of the shareholders
- Other requirements, as per the OECI's request

The tax incentive application fee is \$750.00 USD. Once the tax decree is granted, the business must file annual reports 30 days after the Puerto Rico Corporate Income Tax Return is filed.

