



GUIDE

Puerto Rico Tax Incentives Act 60

Professional Researchers or Scientists

Chapter 2 of Subtitle B, formerly Act 14



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Puerto Rico Tax Compliance Guide

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

The following White Paper is designed to give an insight on Tax Issues in Puerto Rico. It provides relevant background information, which will be of assistance to organizations considering establishing a business on the Island. 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.

Therefore, it is highly recommended to seek advice and counsel from qualified professional sources before undertaking any business.

Torres CPA Group is a Certified Public Accounting Firm that has been offering Audit, Tax, Consulting, and Financial Outsourcing services for over 38 years. If you require any further information or help, please do not hesitate to contact us. We assist in Accounting, Payroll, and Tax Compliance.

Waiver: In accordance with IRS Circular requirements, you are advised that any discussion of tax issues in these materials is not intended or written to be used and cannot be used to avoid penalties imposed under Internal Revenue Code, as amended or to promote, market, or recommend to another party any transaction or matter addressed herein.

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Professional Researchers or Scientists

Act 60 Chapter 2 of Subtitle B of the new Code (formerly known as Act 14)

Qualifies a researcher or eligible scientist that is or will be a resident of Puerto Rico, contracted by the University of Puerto Rico or any other institution of higher education authorized to operate in Puerto Rico and engaged in eligible scientific research subject to certain requirements and certifications, is eligible for an income tax exemption not to exceed one hundred and ninety five thousand dollars (\$195,000) of salaries received.

Additionally, the researcher or eligible scientist contracted to provide scientific and technology research and development services within the regulation established is eligible for an income tax exemption not to exceed two hundred and fifty thousand dollars (\$250,000) of salaries received.

This requires a minimum of sixty (60) hours of community service per year pursuant to the requirements set forth by the Secretary of the Department of Economic Development and Commerce.

Scientific researchers with a doctoral degree that graduate after July 1, 2019 and that commit to establishing their practice in Puerto Rico for a period of seven (7) consecutive years may qualify for a subsidy which has a limit of sixty five thousand dollars (\$65,000) per professional, subject to the availability of the funds, payable at the beginning of the 7-year period and the issuance of the incentive agreement, recapture rules apply once the 7-year period is unfulfilled.

Incentive Program

General Information

The Mission of the Code of Incentives

Convert Puerto Rico into a first order/global level tourist destination of as to a global level, as it also promotes the strengthening of municipalities through tourism.

Encourage the promotion and development of Medical tourism and service facilities of physicians in Puerto Rico.

Take intense action to modernize the infrastructure and reduce the costs of energy through the investment in infrastructure and different alternatives of sources of Renewable Energy.

Encourage the use of technologies that promote the sustainability and production of utilities that are more cost-efficient and cleaner than those provided by the current infrastructure.

Encourage the service industry to export all kinds of services and technology.

Develop Puerto Rico as an International Center of Financial Services and Insurance.

Promote Puerto Rico as a unique location for the film industry and its related activities, including postproduction.

Offer manufacturing, research, development, and high technology industries incentives so that they can preserve and expand their investment in Puerto Rico.

Promote the export of goods and services as a more competitive place than other jurisdictions.

Strengthen the agricultural sector and promote the export and added value of its products.

Strengthen the construction sector to make viable the crucial works that lead to economic recovery and reconstruction of Puerto Rico.

New approach of the Puerto Rico Economic Incentives Act

The Code of Incentives leads to the implementation of the Puerto Rico Incentives Act. It includes the organization by segments and sectors of the industry so that laws can be grouped within the same category, referred to as Chapters.

Chapters:

1. General Incentives Application
2. Individuals
3. Export (Goods and Services)
4. Financial and Insurance Services
5. Visitor Economy
6. Manufacturing, including the component of Research and Development
7. Infrastructure
8. Farming
9. Creative Industries
10. Entrepreneurship

11. Air and sea transport service activities

12. Other

Clause of Validity

The changes established by the new Code of Incentives are of prospective application and do not affect the companies or individuals with Decrees, credits, or incentives granted before its approval.

This Act shall be in effect immediately after its approval on July 1, 2019. Applications for new Decrees under the previous law of incentives will be received until December 31, 2019.

The impositions provided by this Act shall remain in force during the term on which the Decrees issued remain valid.

Bill Of Rights for Decree Holders

The Decrees constitute a contract between the Government of Puerto Rico, the Exempt Business and its shareholders. The terms and conditions to be agreed upon in the contract will be honored during the validity of the Tax Exemption Decree subject to complying with its terms and conditions.

The Decrees are valid throughout Puerto Rico, including its municipalities. Businesses that start operations on a new or different municipality do not need to request an amendment to the Decree to perform the activities covered by the Decree.

If new laws or regulations that provide much favorable terms and conditions are approved or adopted, the Business may request an amendment to reflect the benefits or improved terms for the Business and its shareholders.

Every Exempt Business and its Shareholders will have the right to:

Receive a worthy treatment to be considered without prejudice by part or by all of the officials and employees of the Department of Economic Development and Commerce (“DDEC”) on any management issues.

Negotiate with the Secretary of the DDEC matters of economic development and Decrees concerning issues related to tax and accounting. They will need the endorsement of the Secretary of the Treasury.

A clear and expedite process for obtaining a Decree.

Confidentiality of the information they submit to the DDEC.

The Business and its Shareholders have the right to know the purpose for the request of any information, how it will be used, and the consequences of not providing it.

That they may be assisted by any authorized person to represent them, except for case Professional Certificates, where their representative must be licensed lawyers or public accountants authorized in Puerto Rico.

They will be notified by letter of any amendment to the Decree made by the DDEC as a result of any audit that demonstrates non-compliance. The DDEC will inform the nature of the modification of the Decree and the grounds for the changes, allowing to be heard within the framework of the due process of law.

Administration of the Decrees

The Office of Incentives for Businesses in Puerto Rico (“Office of Incentives”), part of the DDEC, will be responsible for processing, evaluating, and supervising requests for incentive Decrees, Decrees granted and requests for amendments.

Nature of the Decrees

The Decree grants are considered a legal contract between the DDEC, the Business and its shareholders, and the Government of Puerto Rico.

It shall be the obligation of any government agency or instrumentality, public corporation or municipality, to honor and respect such contractual obligations in any administrative or judicial forum.

The contract is construed liberally in such way that it is consonant with the socioeconomic development of Puerto Rico.

A Business that possesses a Decree will perform its operations as represented in its application unless a request for change is filed and approved by the DDEC.

The date of effectiveness of the Decree shall be the date of submission of the request or at time agreed later on.

Job Creation Requirements

Businesses with an actual or projected annual volume of more than three million dollars (\$3,000,000.00) must comply with the following job creation requirements:

- Export of Services & Goods: an equivalent of one (1) full-time employee
- Manufacturing: an equivalent of three (3) full-time employees
- Other activities will not require the creation of jobs.

A qualifying employee is any individual resident of Puerto Rico hired by the Business as an employee, whether full-time, part-time or temporary, that participates directly in the activities covered by the Decree.

For purposes of determining the number of direct employees maintained during the year, the entity must add the total hours worked by all the direct employees during the year and divide this by two thousand eighty (2,080).

Vacation hours and other authorized working licenses may be taken into account as hours worked. However, hours worked in excess of 40 hours per week will not be considered.

Employee resignation or dismissal

In cases in which a regular employee resigns or is dismissed, the Business will have a period of ninety (90) days to hire a new employee. If the Exempted Business hires a new employee during that period, the days on which the vacancy took place will be considered hours worked for the computation of two thousand eighty (2,080) hours.

Reaching Threshold Volumes

In cases in which the requirement of employment is imposed as a result of reaching the current annual volume of more than three million dollars (\$3,000,000.00), after the granting of the Decree must comply with the following:

Twenty five percent (25%) during the first six (6) months

Fifty percent (50%) after the six (6) month period but before twelve (12) months

Seventy-five percent (75%) after twelve (12) months but before eighteen (18) months with

Hundred percent (100%) of the arranged requirement after eighteen (18) months

In those cases in which the requirement of employment is imposed as a result of the annual projected volume, the provisions will be applied in the year following the taxable year in which the Business reached the amount of more than three million dollars (\$3,000,000.00).

Other Business Employees

The Secretary will take into consideration the equivalent of full-time employees of the entity providing services to the employees who have been hired by another Business that provides services directly related to the activities covered by the Decree, including those working under a lease of employee's contract.

Compliance Flexibility

There are some exceptions for businesses that fail to comply with the employment requirement during a given tax year:

If the business met at least eighty percent (80%) of the jobs required, it is deemed in compliance. This exception will not be able to be used for more than three (3) occasions during the validity of the Decree.

If the Business has not complied with at least the required eighty percent (80%) of the jobs, it must request the consent form the Secretary for complying with the requirement during following year. The request shall contain the reasons for the failure; the corrective measures to adhere to the fulfillment of the provision of jobs. This allowance can only be used twice during the validity of the Decree.

Amendment to the Employee Requirement

Any Exempt Business with a Decree granted under Law 73, Manufacturing; Law 20, the exportation of Services & Goods, or Law 135 Young Entrepreneur, may request one amendment to the Decree.

Filing of Reports & Compliance

Reports Required for Exempt Businesses and their Shareholders:

Businesses must file and pay income tax return annually, regardless of the amount of their gross or net income.

All Shareholders must file and pay the annual income tax return.

Businesses will comply with the obligation to maintain in Puerto Rico, the accounting reports that segregate their exempt operations, as well as all supporting records and files.

Businesses and Shareholders will comply, pay, and submit all required declarations, rules, and regulations in force concerning the taxation and collection of all kinds of contributions.

Businesses must electronically file at the Office of Incentives their annual tax return, no later than thirty (30) days after the date prescribed by law for filing the form, including the extensions granted by a report of compliance.

All Shareholders under a Decree must also comply with the annual filing of the tax return at the Office of Incentives.

Every two (2) years or less the Office of Incentives will create an audit of compliance concerning the terms and conditions of the Decree granted.

Payment subject to withholdings

Business payments in excess of \$500 for services performed within Puerto Rico are subject to a ten percent (10%) withholding. The amount withheld should be deposited at the Puerto Rico Treasury Department on or before the tenth (10) day of the month following the close of the month in which the tax was deducted which may be subject to specific exclusions and exemptions. The amount withheld or deposited will be credited against their income tax liability.

Non-compliance with the Obligation to Withhold

If the withholding agent does not withhold the tax imposed, unless the person receiving the income has satisfied his or her tax liability, the withholding agent may be subject to penalties or fines.

Tax Responsibility

Any Person obliged to deduct and withhold the tax imposed, must respond to the Secretary of the Treasury for the payment and will not have to answer to any other Person regarding any payment.

Accounting Records

The Exempt Business will have an obligation to maintain, in Puerto Rico, separately, the accounting related to its exempt operations, as well as the supporting records and necessary files.

System of Compensation for Accidents of Work Fund Insurance, Workers' Compensation

The exemptions and tax benefits will not include fees payable under the Law System of Compensation for Accidents of Work Fund Insurance.

Administrative Fines

The Director may impose an administrative fine of ten thousand dollars (\$10,000) on any exempt business that fails to file any of the reports that the Secretary or the Director may require, or they filed them after the expiration date.

The filing of an incomplete report will be considered as not filed. If the concerned agency notifies the exempt business of any omission in the required report and the exempt business does not submit the missing information within fifteen (15) days of being notified, or does not reasonably justify the lack thereof, the business may be subject to the administrative fine.

Investor Resident Individual Trusts

Trusts for Benefits of the Trustee

A Resident Investor Individual with Decree may establish trusts under the laws of Puerto Rico and may elect that the trusts be treated as trusts for the benefit of the trustor (“grantor trust”) for purposes of income tax in Puerto Rico.

The election will be made in accordance with the rules established, irrespective of whether the trust is not considered for the benefit of the trustor under the applicable income tax rules.

The nature of income, gain, loss, deduction or credit included in the income attributable to the settlor shall be determined as if it was made directly from the source and the trust made or accrued it in the same way the trust earned it. An election made, once made, may only be revoked by the procedure established by the Secretary of the Treasury.

Revocable Trusts

An Investor Resident Individual may establish a revocable or irrevocable trust under the laws of Puerto Rico, as determined by the trustor in the articles of incorporation. In the absence of a provision in this regard, it shall be presumed irrevocable. Revocable trusts established following this provision may only be revoked by the trustors, or by the trustor who retains this power in the articles of incorporation.

Trusts granted outside of Puerto Rico

The provisions of any Trust validly granted outside of Puerto Rico by an Investor Resident Individual to which a Decree is issued, may not be challenged by any person based on any Puerto Rico Law or Regulation that could be contrary to or inconsistent with the provisions of said Trust. This will continue to be applicable after the termination of the exemptions granted provided that the Decree has not been revoked.

A Resident Investor Individual to whom a Decree is issued may freely transfer or donate in life, and in its sole discretion, all or part of their assets to the trusts, irrespective of whether they are tangible or intangible movable or immovable property, of the location of said assets, and of any legal or regulatory provision in Puerto Rico that is contrary or inconsistent with said transfer, donation, testamentary disposition of the flow and/or the terms and conditions of said Trusts.

Other Benefits

Flexible Tax Exemption

The entities will have the option to choose the specific years of effectiveness under their Decrees and will notify the DDEC no later than the date for filing the income tax, including the extensions

granted. An Exempted Entity that opts for this benefit, will have the period of exemption extended for purposes of the tax on income by the number of taxable years they have not enjoyed a Decree.

Automatic benefit Application

The other terms, conditions, and benefits contained in the new Code that do not conflict with the current Decree will apply to the Exempt Business without needing to file an amendment.

Businesses with previous eligible activities

If by the date of submission of the application of Decree, the Entity is dedicated to an activity eligible through any time during the period of three (3) tax years prior to the date of submitting the application, the "time base", the entity can enjoy the fixed rate on income only in regard to the increase of net income of the activity. The base period requirement will include any operation under another legal name, or with other owners.

The net income of time base shall be subject to the ordinary rates, which will be adjusted by twenty five percent (25%) annually, until reduced to zero (0) at the fourth year.

Conversion of exempted businesses under Laws of Previous Incentives

Businesses that were granted an exemption under Previous Incentives Laws may apply to the new provisions, provided that they can demonstrate that they comply with all the legal applicable requirements. The benefits granted in the converted Decrees may not be greater than those provided under the new law.

Businesses that as of July 1, 2019 have not begun operations, may apply to convert the remainder of the period of the Decree to adjust their Decree according to the benefits granted under the new Code.

Businesses whose Decrees were granted on or before July 1, 2019, and have begun enjoying the exemption may apply to convert it according to the benefits granted under the new Code.

The conversion will have to be requested within a term of twelve (12) months beginning on July 1, 2019, and can be reset to the first day of the taxable Year but never before July 1, 2019.

Revenues accrued for the business until the date of effectiveness of the conversion, which is distributed after the date effective of the conversion, will be subject to the tax treatment which is arranged in the law under which they were accumulated.

The other terms, conditions, and benefits contained in the new Code which do not represent a conflict will apply to Exempt Businesses automatically.

Exempt Business Ownership Transfers

The transfer of the Decree, or the Shares or majority ownership of an Exempt Business to another person who, in turn, will continue to devote himself to the Activity to which he was previously engaged in a substantially similar manner, will require the prior approval of the Secretary of the DDEC.

Making a transfer without prior approval will void the Decree at the time of the transfer. Notwithstanding the preceding, the Secretary of the DDEC may approve any transfer made without its approval with retroactive effect.

Any transfer request must be approved or denied within sixty (60) days following its filing. The denial of a transfer request must be made in writing and will detail the reasons why it is rejected. Any transfer request that is not authorized or denied within this period will be considered approved.

The following transfers will be authorized without prior consent:

The transfer of the assets of a descendant to his estate or the assignment by legacy or inheritance;

The transfer of Shares of the Exempt Business when the said transfer does not directly or indirectly result in a change in the domain or Control of the Exempt Business;

The pledge or mortgage granted in the ordinary course of business to provide a guarantee of a bona fide debt does not prevent any transfer of Control, title or interest under the said contract, however, this shall be subject to notification;

The transfer by operation of law, by order of a court or a bankruptcy judge to a trustee. Any subsequent transfer to a third person other than the same debtor or bankrupt above will be subject to the notification provisions.

The Exempt Business will report any transfer of the exceptions to the Secretary of the DDEC within thirty (30) days of being made.