



Growing
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GUIDE

Puerto Rico Tax Incentives Act 60

Manufacturing, Research and Development

Chapter 6 of Subtitle B, formerly Act 73



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Puerto Rico Tax Compliance Guide

By TCG, Torres CPA Group, CifrasPR, Torres & Soto Tax

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.

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's 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 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.

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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Manufacturing, Research and Development

Act 60 Chapter 6 of Subtitle B of the new Code

(formerly known as Act 73)

Manufactured Product

Manufactured Product is and includes products transformed from raw materials, including plant material or animal matter, and any product in a substantial industrial operations carried out in Puerto Rico.

An Exempt Business may subcontract the production in Puerto Rico of one (1) or several components or products, or one (1) or more manufacturing processes, or services related to the processes of products covered under its Decree or critical functions necessary to its operation and the subcontractor will also qualify as an Eligible Business, provided that the Secretary of the DDEC determines that such subcontracting will result in the best interests of Puerto Rico.

Manufacturing Entities

An established business, or one that will be established in Puerto Rico, may request the Incentive Grant from the Secretary of the DDEC when engaged in one of the following eligible activities:

1. Industrial Unit that is established permanently for the Production of a Manufactured Product on a Commercial Scale.
2. Manufacture of boxes, containers, and containers produced from corrugated cardboard, as long as the Manufactured Products are sold abroad.
3. Industrial Unit were it is not economically feasible to carry out the entire manufacturing operation in Puerto Rico, therefore required to carry out part of the process or elaboration outside of Puerto Rico.
4. Bonafide office, business or establishment with its equipment and machinery, the capacity and expertise necessary to carry out on a commercial scale the provision of a service, provided that it complies with Puerto Rico's Fundamental Services to Business Conglomerates or Key Supplier Services.
5. Property dedicated to Industrial Development.
6. Animal husbandry for experimental uses in laboratories for scientific research, medicine, and similar purposes.
7. A company that engages in scientific or industrial research and development to develop new products, or develop new services or industrial processes through basic or applied experimentation.

- a) The term "research and development" is any activity that is carried out to advance knowledge or capacity in a field of science or technology, through the resolution of scientific or technological advances. The new knowledge that results from research and development must be useful for creating new products, improving them, or creating new services or processes of commercial value.
- b) Research and development is to improve industrial processes (continuous improvement), as well as research and development processes carried out by contract by any company for the benefit of a third party (contract research), are excluded for Tax Credits.

8. Recycling activities defined as:

- a) Partial recycling activities that carry out at least two or more of the following processes: collection, distribution, reconditioning, compaction, crushing, spraying, or other physical or chemical process that transform the items of recyclable materials or recyclable and recovered materials in Puerto Rico, in raw material, aggregates for the preparation of a product, prepare the material or product for sale or local use or export, and that sell or use locally or export the processed material or product for further use or recycling.
- b. Total Recycling Activities that are a transformation into articles of commerce of recyclable materials that have been recovered mainly in Puerto Rico, subject to such activity contributing to the objective of promoting the recycling industry in Puerto Rico.

9. Plantings and crops vertically integrated with value-added processes, such as the process of nutrition (hydroponics), as well as the intensive cultivation of mollusks, crustaceans, fish or other aquatic organisms through the aquaculture process, the process of milk pasteurization and Agricultural Biotechnology processes, provided that these operations are carried out in accordance with the standards and practices approved by the Department of Agriculture, as well as any other agro-industrial or agricultural activity, including those operations exclusively dedicated to packaging, preservation, classification or processing of agricultural products.

10. Value-added activities related to the operation of the Port of the Americas, the port located in the former Roosevelt Roads Base, and the ports of Mayagüez, Yabucoa, San Juan, Guayama and any other port designated by the Secretary of DDEC: storage, consolidation of merchandise and clearance, repackaging of consolidated products for shipment from these ports, the termination of semi-processed products for shipment to regional markets, and any other commercial or service activity related to the administration and management of finished goods or products, semi-processed or manufactured that are associated with, are part of, or run through the ports.

11. Development of licensed or patented programs or applications (software), which can be reproduced on a commercial scale and have the following attributes, the user interacts with the program to perform specific tasks of value and business models can involve: (A) the distribution of physical form, in the cyber network or by cloud computing or as part of a blockchain and (B) the income comes from licensing, program subscriptions and / or service charges. The following tasks are considered ineligible:

- a. Company of content publications in the cyber network and its search device.
- b. A company that uses technology to provide a service and does not have the human resources to develop new products.
- c. A company where the primary income is for advertising and marketing of the Puerto Rico market.
- d. The program does not contain a methodology to perform a valuable task.
- e. Programs that include gambling where entry is a bet.

12. Research, development, manufacturing, transportation, launch, operation from Puerto Rico of satellites and development service centers for data processing and storage, excluding telephony, broadcasting and broadcasting operations.

13. The licensing of Intangible Property developed or acquired by the Exempt Business.

14. The repair, maintenance and general conditioning of aircraft and maritime vessels, as well as their parts and components.

15. The development of video games that can be reproduced on a commercial scale.

Legal, accounting, or tax advice services will not constitute critical services.

Tax Benefits

Term of the Decrees

Decrees of exemption will have a term of 15 years, with a possible renegotiation for additional time of 15 years.

It is required to apply to Decrees to obtain the benefit, including for Private Capital Funds.

4% Fixed Net Income Tax Rate

The eligible activities will be subject a preferential of tax on net income of a four percent (4%), in place of any other income tax. The funds from an insurance policy for the concept of

interruption of business (business interruption) to cover the eligible activities, will also be considered.

0% Federal Income Tax of 0%

The eligible activities will not be subject to any US Federal Income Tax on income source in Puerto Rico.

100% Tax Exemption on dividends or profit distributions

The shareholders or partners in a domestic corporation or company that owns a Decree will not be subject to tax on income on distributions of dividends or profits.

However, a non-domestic corporation will pay ordinary taxes on distributions of dividends or profits of income from sources outside of Puerto Rico.

75% Exemption on Property Tax

Real Estate and Movable Property will be exempt of seventy and five percent (75%) exemption on the taxes, at the tax rate that is in effect at the date of signing the Decree, regardless of any amendment later made in the Decree.

The Shares in an entity that enjoy a Decree will not be subject to tax on the property.

50% Tax Exemption on Municipal License Taxes

The gross income of eligible activities has fifty percent (50%) of exemption in the municipal taxes, including on the municipal license and any other taxes imposed by any municipal ordinance.

The Municipal license tax rate that applies is the rate as of the date of the signature of the Decree, regardless of any amendment later.

100% First two semester exemption

An exemption of 100% over the municipal licenses applicable to the volume of business during the two semester of fiscal Year in which it begins operations in any municipality.

100% of Exemption on Construction Excises tax

A Exempt Entity, its contractors and subcontractors are fully exempt (100%) from any tax, license , excise taxes on construction , or fee imposed by any city ordinance on the construction works to be used in their operations , except municipal license taxes imposed on the volume of business of the contractor or subcontractor.

Is deemed as construction work if it is to be used for the operation and to facilitate the operation, regardless of whether it owns all or partial, lease or any other way.

The Business, nor its contractors or subcontractors, will have to submit any certification issued by the municipality as to evidence of having paid the excise taxes on construction for the issuance of any permit.

100% Tax exemption on Excise Tax and Sales and Use Tax

An exempt entity will not pay Excise tax or Sales and Use tax on eligible activities source including:

1) raw material for use in Puerto Rico in the production of finished products, excluding hydraulic cement, crude oil, partially processed products, and finished petroleum products and any other hydrocarbon mixture. The natural gas or propane gas used for the generation of distributed electrical or thermal energy shall be considered as raw material. The term "raw material" shall include:

- a) any product in its natural form derived from agriculture or extractive industries;
- b) any by-product, residual product or partially processed product or finished product; Y
- c) sugar in bulk or in units of fifty (50) pounds or more, to be used exclusively in the manufacture of products.

2) The machinery, equipment and accessories of these that are used exclusively in the manufacturing process, or in the construction, or repair of vessels, inside or outside the premises of a manufacturing plant, machinery, trucks, or forklifts that are used exclusively and permanently in the conduction of raw material within the circuit of the Exempt Business, machinery, equipment and accessories used to carry out the manufacturing process, or that the Exempt Business is required to acquire as a requirement of law, federal regulation, or State for the operation of an Industrial Unit. Notwithstanding the foregoing, the exemption will not cover machinery, equipment, or vehicles that are used in whole or in part, in the administrative or commercial phase of the Exempt Business, except in those cases where they are also used in less than ninety percent (90%) of the manufacturing process, or in the construction or repair of vessels, in which case they will be considered as used exclusively in the manufacturing process.

3) The machinery and equipment acquired directly and indirectly and must be used to comply with environmental, safety and health requirements, will be exempt from the payment of state taxes, as well as the sales and use tax.

4) Machinery, materials, equipment, parts and accessories that are used in experimental or reference laboratories including, but not limited to, those used for any research and development activity of science and technology, and in technological research and renewable energy research projects, within Puerto Rico's Science, Technology and Research District.

5) The machinery, equipment, parts, and accessories used in the preliminary phase of exploration of regions with a view to the mineralogical development of Puerto Rico, and the dock and shipyard docks for the construction or repair of vessels.

6) The fuel used in the generation of electrical energy and/or thermal energy for their use or its Affiliates.

7) Chemical materials used by an Exempt Business in wastewater treatment.

Exceptions

The following articles of use and consumption use, regardless of the area or property where they are located or of their use, shall not be considered as raw material, machinery or equipment exempt;

- (1) all construction materials and prefabricated buildings;
- (2) all electrical equipment and water pipes embedded in structures;
- (3) lubricants, greases, waxes, and paints not related to the manufacturing process;
- (4) lightning poles and luminaires installed in parking areas;
- (5) treatment plants and electrical sub-stations.

100% Exemption on Gross Capital gains

Only the net capital gains will be subject to municipal tax, as well as any other net gain obtained in the sale of any asset or property used in the operations.

100% Exemption Taxation of Eligible Investment Income

An Exempt Business will enjoy a total exemption on Eligible Investment Income. The expiration, renegotiation, or conversion of the Decree shall not prevent the income accrued from the investment from being treated as Eligible Investment Income during the remaining period of the investment.

100% Exemption on Sale or Exchange of Shares or Assets

Gains made on the sale, exchange provision of equity, either as a dividend or as a distribution in liquidation, will be exempt from additional taxation.

100% Exemption Royalties, Fees (Royalties) or rights source in PR

However, for activities derived from sources within Puerto Rico, a tax of twelve percent (12%) will be deducted and withheld at the source, on the amount received for concept of royalties, fees or right of use, or any Intangible property related to the exempted activities paid by any foreign corporation, foreign society or person not engaged in industry or business in Puerto Rico.

4% Fixed Net Income Tax Rate Fundamental Services to Business Conglomerates (Clusters)

The provision of service in Puerto Rico, through subcontracting, that is fundamental to the production process of an Exempt Business dedicated to manufacturing, and that belongs to business conglomerates classified as having a high economic impact by the Secretary of DDEC.

4% Fixed Net Income Tax Rate *Key Supplier Services*

Providing in Puerto Rico services on a commercial scale and on an ongoing basis to an Exempt Business as a key supplier that is a Unit dedicated to manufacturing.

A supplier is considered to be key if its services allow the Exempt Business to be its usual customer to concentrate its activities in the areas of its core competence.

In the case of the service units, not less than eighty percent (80%) of the employees, technicians, and professionals of the service unit shall be Resident Individuals of Puerto Rico.

If a provider is operating in Puerto Rico before submitting an application, they will be subject to the limitations regarding the entry base period.

Key Supplier Services Eligible Activities:

Specialized storage, management of raw material inventory, material in process, finished product and parts inventory, including receipt, storage, and inspection.

Logistics, distribution, and export of Manufactured Products, except transportation services of material and documents offered by businesses mainly dedicated of transportation to the consumer and non-exempt companies.

Insertion and distribution of printed material required by federal or state laws or regulations before any Manufactured Product can be distributed or put on sale.

Document digitalization.

Sterilization of instruments, equipment, and cleanroom clothing.

Quality control services and validation of processes, equipment and systems.

Qualification of equipment, utilities or facilities, and calibration and maintenance of equipment.

Repair and remanufacturing of products.

Process engineering, which may include, among others, the design of systems and processes that improve the quality and productivity of the operations covered under the Decree.

Programming services and data systems management.

Specialized technical training

Development and reproduction of educational programs.

Logistics related to the purchase and sale of Manufactured Product.

4% Fixed Net Income Tax Rate *Property Dedicated to Industrial Development*

Real estate, including land and improvements, or parts thereof, as well as any addition equivalent to not less than twenty-five percent (25%) of the main floor area, dedicated to the exploitation of an industry that is made available and used or owned by an Exempt Business that holds it for development, organization, construction, establishment or operation.

Set of machinery and equipment necessary for an Exempt Business that has a Decree to carry out the activity that is owned, installed, or in some way used under a contract.

4% Fixed Net Income Tax Rate *Industrial Development Income:*

The net income derived from the operation of activity eligible for an Exempt Business that has a Decree, including the income of the operation when making a Flexible Tax Exemption election.

Creation of Jobs Requirements

A Business with an annual volume, actual or projected, of more than three million dollars (\$3,000,000.00) needs to hold at least for Export of Services & Goods, one (1) employee full-time equivalent; Manufacturing three (3) employees full-time equivalent; Other activities will not require the creation of jobs.

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

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

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

The Income of Eligible Investments

The net income derived from the operation, as a result of the currency exchange, that is attributable to the sale of products or the provision of services to foreign countries, including the net income derived from hedging transactions.

The income received as a dividend or benefit by a corporation or company that has Shares in the Exempt Business, which makes the distribution and that the income is attributable to Industrial Development Income derived from an Exempt Business.

The derived net income, by way of insurance policies for business interruption, as long as there is no reduction in the level of employment in the Exempt Business.

Net income derived from the sale of Intangible Property and any other right to receive income related to activities or Intangible Property owned.

Special Deduction for Investment in Buildings, Structures, Machinery and Equipment (accelerated deduction)

Every Business will be granted the choice to deduct in the taxable year in which they incurred, instead of any capitalization of expenses, an acceleration of the deduction of costs.

The total expenditures incurred after July 1, 2019, in the purchase, acquisition or construction of buildings, structures, machinery and equipment, provided that these buildings, structures, machinery, and equipment have not previously been used or depreciated by any other business or person in Puerto Rico; and are used to manufacture the products or provide the services under the granted.

In the case of machinery and equipment previously used outside of Puerto Rico, but not previously used or depreciated in Puerto Rico, the investment will qualify for the special deduction only if the machinery and equipment still has at least fifty percent (50%) of its useful life.

The amount of the Manufacturing Investment for the special deduction provided in the Industrial Development Income of the Exempt Business may be claimed as a deduction in subsequent Tax Years until the excess is exhausted.

The portion of the investment in buildings, structures, machinery and equipment on which the Exempt Business receives or has received Tax Credit will not be allowed.

Commencement Date

The exemption period will begin on January 1 of the year in which the Eligible Business begins, but never before January 1 of the year in which the filing of an application occurs.

In the case of Exempt Businesses that have been operating on a commercial scale before applying, the date of commencement of operations will be the date of filing of an application in the Incentives Office, but the date of commencement may be postponed for a period not exceeding two (2) years from the date.

The Exempt Business shall begin operations on a commercial scale within one (1) year from the date of the signing of the Concession. It may be extended at the request for just cause, but no extensions will be granted that extend the date of commencement of operations for a term greater than five (5) years from the date of approval of the grant.

Successor of a Manufacturing Business

A Successor Manufacturing Business may benefit from as long as:

- (1) the Previous Business has not ceased operations for more than six (6) consecutive months before the filing of the application.
- (2) the Manufacturing Priority Business maintains its average annual employment for the three (3) Tax Years that end with the closing of its Tax Year before the filing of the application.
- (3) the employment of the Successor Manufacturing Business, after its first year of operations, is greater than twenty-five percent (25%) of the average annual employment of the predecessor business;
- (4) The Successor Business does not use physical facilities, including land, buildings, machinery, equipment, inventory, supplies, trademarks, patents, distribution facilities (marketing outlets) an ancestor business has previously used fifty thousand dollars worth (\$50,000.00) or more.

The foregoing shall not apply to the additions to the Property Dedicated to Industrial Development, even if these constitute physical facilities that have a value of fifty thousand dollars (\$50,000.00) or more and are being, or have been used by the main unit or the Previous Business.

Granting of the Tax Credit

The Tax Credit granted may be taken in two (2) or more terms: fifty percent (50%) Tax Credit may be taken in the Tax Year in which the Special Eligible Investment is made and the balance in subsequent years until it runs out.

An amount equivalent to the Tax Credits that you receive for a research and development activity will have to be reinvested by the Exempt Business for research and development activities in Puerto Rico.

General Rules for the Granting of Tax Credits

The Secretary of the DDEC is authorized to establish Tax Credits for particular programs and projects to maximize their economic impact, the Return on Fiscal Investment and their performance. The Tax Credits will be granted through an incentive contract between the DDEC and the Exempt Business.

Tax credits will be granted to Exempt Businesses that have a Decree.

The tax credits may be used, against one hundred percent (100%) of the tax liability determined for that year, any unexpired return, including under valid extension, even if it is one year before the granting of the tax credit.

Tax credits may be carried over until they are exhausted but cannot be refunded, may be assigned, sold or in any way transferred.

The base of the assets that comprise all the investment that generates the tax credits will be reduced by the amount taken as a credit for such investment, but it can never be reduced to less than zero.

Tax Credit for Purchases of Products Manufactured in Puerto Rico

Purchases of Products Manufactured in Puerto Rico, including components and accessories, or purchases of used products transformed into merchandise made of recycled materials, or with raw material from recycled or collected or reconditioned materials may claim a Tax Credit of up to twenty-five percent (25%) of purchases of the products made during the Tax Year. This Tax Credit will be granted only for purchases of products that have been manufactured by companies not related to the Exempt Business.

All Businesses claiming a Tax Credit must request an accreditation certificate issued annually by the DDEC, which will certify the eligible purchases for the granting of the Tax Credit.

They will be non-transferable. The amount of the tax credit not used by the in a taxable year may be carried forward to subsequent taxable years, until it is used in its entirety but will not generate a refund.

In the case of an Exempt Business whose Decree has been granted under Previous Incentive Laws, the credit provided will not be available if the Exempt Business claims any special deduction or credit of a similar nature under previous incentive.

Tax credits will be granted to Condo Hotel Developers

The Exempt Business will have ownership of the tax credits. In the case of a Condo hotel, and only for tax credit purposes, the Condo hotel Developer may choose between requesting the tax credit for himself or reserving the tax credit for the purchase of a Condo hotel unit to claim.

Tax credits may be carried over until they are exhausted but cannot be refunded, tax credits may be assigned, sold or in any way transferred.

Tax Credit for Science and Technology

Tax Credit for Investment in Research and Development

Any Exempt Business that has, subject to the approval of the Secretary of the DDEC, a Tax Credit for investment of up to fifty percent (50%) of the Special Eligible Investment made in Puerto Rico within the Tax Year after July 1, 2019, subject to the limits, terms and conditions established by the Secretary of the DDEC.

You must request an accreditation certificate issued annually by the DDEC, which will certify that the research and development activities carried out in Puerto Rico are eligible.

The certificate must be requested on or before the deadline to file the income tax return corresponding to the Taxable Year in which the Eligible Investment was carried out, including any extension granted for filing. The certification must include the amount of the Special Eligible Investment, which must be supported by the presentation of Agreed Procedures (Agreed Upon Procedures) made by an Authorized Certified Public Accountant with a valid license in Puerto Rico, and the amount of the Tax Credit granted for each Tax Year Said certification must be included with the return as a requirement to grant the claimed credit.

Credit for Technology Transfer Investments

Exempt Businesses may take a credit against the income tax attributed to the net income of their Industrial Development Income. The tax credit will not be transferable, may be carried forward for a period of eight (8) tax years but will not be refunded.

Credit Application and Minimum Tax

An entity will initially compute its tax liability according to the applicable fixed income tax rate, applicable credits will be reduced it, but will never be less:

1. If an average gross income is less than ten million (\$10,000,000.00) dollars during the three (3) previous taxable years, the minimum tax will be one percent (1%);
2. A local investment business that directly belongs at least fifty percent (50%) to Resident Individuals of Puerto Rico three percent (3%);
3. In all other cases, the fixed income tax rates outlined in the Decree, excluding Eligible Investment Income.

Base adjustment

The basis of any asset for which the Tax Credit is claimed will be reduced by the amount of the Tax Credit claimed.

The Exempt Business may not request this Tax Credit concerning the portion of the Special Eligible Investment on which it takes or has taken the special deduction or similar deduction under Incentive Laws. This Tax Credit will not generate a refund.

Period of prescription for the assessment and collection of licenses

The period of prescription on municipal license shall be for three (3) years if the entity gives up the benefit of a discount of five percent (5%) for prompt payment and make the total payment of its license on the due date.

Property Tax Auto Appraisal Method Optional

A Business may use the self-appraisal method to determine the classification and contribution on real property on a property that has not been appraised.

The self-assessment method may be used exclusively for that property that is properly considered as a real estate property of the intended use and location, and is used in the development, organization, construction, establishment or operation of the eligible activity.

The appraised value of the property classified as real estate will be equal to thirty-five percent (35%) of the depreciated value in the Business books. The appraised value will not be less than determined percent of the cost, calculated based on the useful life of the property from 2-5 years 25%;6-10 years 17%;11-15 years 15%;16 years or more 10%.

Any Exempt Business that has chosen to use the self-appraisal method will submit a tax return on self-assessed real estate no later than May 15 of each year and will determine and pay its obligation.

Once the property is appraised by the CRIM, the value will be that established by the CRIM. CRIM will not be determined as a deficiency the self-appraisal method.

Businesses operating in Vieques and Culebra

Additional Benefits

Income Tax

The Income generated of eligible activities carried out by an Exempted Entity in the island municipality of Vieques and Culebra will be subject to a fixed rate for taxes of two percent (2%) for a period of five (5) years, and four per cent (4%) for the period remaining of the Decree.

Property and Municipal License Tax

Also, enjoys a hundred percent (100%) exemption on taxes on the property, as well as of municipal taxes for the first five (5) years of the Decree of Exemption. The period remaining will enjoy a seventy-five percent (75%) exemption on taxes on property, and fifty percent (50%) of exemption on city taxes.

Credit Tax for Purchases of Products Manufactured in Puerto Rico

During the operating period in the island municipality of Vieques or Culebra, the entity can apply the DDEC taxable credit up to thirty percent (30%) of purchases of Products Manufactured in Puerto Rico.

The credit will be non-transferable. The amount of credit not used in a tax year may be applied to subsequent years until is used in its entirety but will not generate a refund.

Incentive Program *General Information*

The Mission of the Code of Incentives

Convert Puerto Rico in a tourist destination of first order as to a global level, as it 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.

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

Encourage the service industry to export of 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 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 exporting of goods and services in a more competitive way to other jurisdictions.

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

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

New approach of the Puerto Rico Economic Incentives Act

Leading change to the law of economic incentives is the establishment a Code of Incentives, including the organization by segments and sectors of the industry so that laws can be a group within the same category referred as Chapters.

Chapters:

1. Incentives of general 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. Transport air and sea 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 enter into force immediately after for its approval on July 1, 2019. They will receive applications for new Decrees under the previous law of incentives until December 31, 2019.

The impositions provided by this Act shall remain in force during the term in 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 Decree of exemption tax subject to complying with its terms and conditions.

The Decrees are valid in all Puerto Rico, including its municipalities. When one Business starts operations in a new municipality, they do not need to request an amendment to the Decree to perform the activities covered by the Decree.

When a new law is approved, or regulations are adopted, which provides much favorable terms and conditions, the Business may request an amendment that reflects the benefits or better terms for the Business and its shareholders.

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

Receive a worthy treatment, considered an impartial by part of all the officials and employees of the DDEC in any management issues.

Negotiate with the Secretary of DDEC in the matters of economic development and Decrees concerning matters of tax and accounting nature, you will need the endorsement of the Secretary of the Treasury.

A clear and expedient process for obtaining a Decree.

Guarantee the confidentiality of the information they submit to the DDEC.

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

That they may be assisted by any person authorized to represent them, except that in the case of Professional Certificates, these will have to be licensed lawyers or public accountants authorized in Puerto Rico.

They will be notified by letter of any amendment to Decree made by 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 Degrees

The Office of Incentives for Businesses in Puerto Rico (“Office of Incentives”), attached to 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 Decrees grants are considered a contract between the DDEC, its shareholders, and the Government of Puerto Rico, the contract is the law between the parties.

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 a way consonant to promote 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 a time later agreed.

Creation of Jobs Requirements

Businesses with an annual volume, actual or projected, more than three million dollars (\$3,000,000.00) need to hold at least for Export of Services & Goods, one (1) employee full-time equivalent; Manufacturing, three (3) employees full-time equivalent; Other activities will not require the creation of jobs.

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

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

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

An employee resigns and 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 in 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:

During the first six (6) months, you should keep twenty five percent (25%);

then after six (6) months but before the twelve (12) months, you must keep fifty percent (50%);

then after twelve (12) months but before the eighteen (18) months, you must comply with seventy-five percent (75%);

then after the eighteen (18) months, you must abide by a hundred percent (100%) of the arranged requirement.

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 Employee

The Secretary will take into consideration the employees at full-time equivalent 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 Flexible

A business that fails to comply with the requirement of employment provided for a year tax:

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

If the Business has not complied with at least the eighty percent (80%) of the jobs required, it must request the Secretary to allow complying with the requirement during following year. The request shall contain the reasons for the failure, the corrective measures to adhere to for the fulfillment of the provision of jobs. This cannot be used more than two (2) times during the validity of the Decree.

Employee require amendment

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 income 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, accounting segregating their exempt operations, as well as all supporting records and files.

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

Businesses, will annually file electronically with the Office of Incentives, no later than thirty (30) days after the date prescribed by law for the filing form of tax on income, including the extensions granted by a report of compliance.

All Shareholders under a Decree, must annually file electronically with the Office of Incentives, not later than thirty (30) days after the date prescribed by law for the filing form of tax on income, including the extensions granted by a report of compliance.

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

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 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 will be impose.

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 any other Person as to 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 if file them after the expiration date.

The filing of an incomplete report will be considered as not filed, if the agency concerned notifies the business exempt from 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.

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 was made directly from the source as if trust made it, or accrued 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 to be effective under their Decrees and will notify the DDEC no later than the filing income tax date, 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 exempted under Laws of Previous Incentives 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 its 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 from 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 treatment tax 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.