



# Tax incentives in Puerto Rico: an overview

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For more than 60 years, Puerto Rico has used its unique territorial framework to enact numerous tax incentives programs that have served as its main economic development tool.

Puerto Rico is a territory of the United States, and the majority of US laws apply in Puerto Rico. However, as a territory of the US, Puerto Rico possesses the authority to establish its own tax system. For US federal income tax purposes, income derived in Puerto Rico and income tax paid to Puerto Rico are generally treated in the same manner as income derived in and taxes paid to a foreign country. The combination of these factors has permitted Puerto Rico to offer investors from the US and all parts of the world a unique business and legal environment.

Until the enactment of Act 60-2019, PR's incentives program was covered in multiple pieces of legislation that had been put in place over many years. Act 60-2019, also known as the Puerto Rico Incentives Code (PR-IC) was created to update and combine within one piece of legislation a number of these incentives programs, while adding even more new economic development initiatives.

The PR-IC covers a variety of targeted economic activities that are considered essential to Puerto Rico's economic development in such areas as manufacturing, tourism,

international banking, international insurance, private equity funds, green energy, infrastructure and export services. Thus, the PR-IC now serves as the centerpiece of Puerto Rico's incentives program for economic development is a recognition of the importance of direct foreign investment, placing the Commonwealth on par with the most competitive global jurisdictions for technology and high-added-value industries.

In this handbook, we highlight some of the tax incentives available under the PR-IC for certain targeted activities (Eligible Businesses) that may apply for and obtain a tax decree (Decree) to enjoy these incentives, including certain requirements applicable to each type of Decree. Our summary does not cover all the activities that may be eligible for tax benefits under the PR-IC, as mentioned in Section XVI.<sup>1</sup>

We also provide an overview on certain tax benefits available for investments in Qualified Opportunity Zones as well as the general tax treatment of Public Private Partnerships (P3s).

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<sup>1</sup> This publication does not cover tax benefits available to bona fide farmers, hard-to-hire professionals, qualified physicians and eligible scientists or researchers, certain entrepreneurial activities, as well as maritime transportation activities.



# I. Puerto Rico income taxes: general framework

Domestic corporations are subject to income taxes on their net income at rates that range from 18.5 percent to 37.5 percent, and an alternative minimum tax of \$500 or up to 23 percent. Dividends distributed by domestic corporations are also subject to Puerto Rican income tax at rates that depend on the type of shareholder that receives the dividend.

Similar income tax rates apply to foreign corporations engaged in a trade or business in Puerto Rico. In addition, a 10 percent branch profits tax could also apply to these foreign corporations.

Individuals who are residents of Puerto Rico (PR Residents) and US citizens are generally taxed at the ordinary rates on net income at rates that range from 7 percent to 33 percent, but they enjoy a 15 percent income tax rate on capital gains and dividend distributions. Individuals that are not

residents of Puerto Rico or US citizens are subject to special rules.

The municipal governments also impose property taxes, construction excise taxes and taxes on gross revenues (known as the municipal license tax).

The purpose of the PR-IC is to reduce the impact of the above taxes for certain targeted activities, as further described herein.



## II. General tax incentives

The tax benefits that are offered by the PR-IC are covered by a “Decree” issued to an “Eligible Business.” An Eligible Business that has received a Decree is hereafter referred to as an “Exempt Business.”

The general tax benefits that are offered by covered by a Decree consist of the following:

- 4 percent income tax rate on the net income from the activities covered by the Decree
- An income tax rate below 4 percent but not lower than 1 percent on the net income from pioneering activities, as determined by the Secretary of the Department of Economic Development and Commerce (DDEC, for its Spanish acronym) based on a number of factors to be provided under regulations to be issued under the PR-IC
- 100 percent income tax exemption on distributions of earnings and profits generated by the Exempt Business
- 100 percent real and personal property tax exemption during a construction-in-progress period; 75 percent real and personal property tax exemption thereafter
- 50 percent municipal license tax (MLT) exemption, the rate of which will be fixed at the time the Decree is signed
- 75 percent municipal construction excise tax exemption (Construction Tax) on the construction of property to be used in the activities of the Exempt Business covered by the Decree (Exempt Activities), which exemption is extended to contractors and subcontractors engaged for the construction work and
- Special incentives exist for Exempt Businesses classified as small and medium sized businesses (PYMEs, for its Spanish acronym) or that operate in the municipalities of Vieques or Culebra.

Once issued and unconditionally accepted, a Decree will generally be effective during a 15-year exemption period, which could be potentially renegotiated into a new Decree at the end of the 15-year term, or extending the Decree, in both cases, for an additional 15-year exemption period.<sup>2</sup>

As further explained in the sections that follow, special rules, exemptions, credits and incentives apply to specific types of Eligible Businesses in addition to the general benefits discussed above.



<sup>2</sup> A Decree is considered a contract between the Exempt Business, its owners (stockholders or partners, as applicable) and the PR government.

### III. Application process

An Eligible Business must file an application to request and obtain a Decree to enjoy the tax incentives offered by the PR-IC. The application is electronically filed in the Puerto Rico government's online platform<sup>3</sup> for conferring this type of incentives, and depending on the specific Exempt Activity, certain requirements must be met or complied with to obtain the Decree, which is issued by DDEC's Secretary.

In the discussion that follows, we provide a high -level summary of the business operations that could be considered Exempt Activities and the specific tax benefits available to the particular eligible activities discussed herein, as well as the eligibility requirements for each activity.



<sup>3</sup> <https://ogpe.pr.gov/freedom/login/auth>



## IV. Manufacturing activities

The PR-IC provides tax incentives to businesses in Puerto Rico that are engaged in manufacturing of products on a commercial scale, as well as businesses engaged in scientific or industrial research and development of new products, total or partial recycling operations, hydroponics, development of certain software programs or applications, the licensing of intangible property developed or acquired by the Exempt Business, development of video games that can be reproduced on a commercial scale, value added activities related to the operations of certain ports, including the Roosevelt Roads Base port and those designated for such purposes by DDEC's Secretary, and repair and maintenance to aircrafts and vessels, among others (collectively referred to as Manufacturing Activities).

Exempt businesses engaged in Manufacturing Activities must also have at least three direct full-time employees if actual or projected gross income exceeds \$3 million, among other conditions.

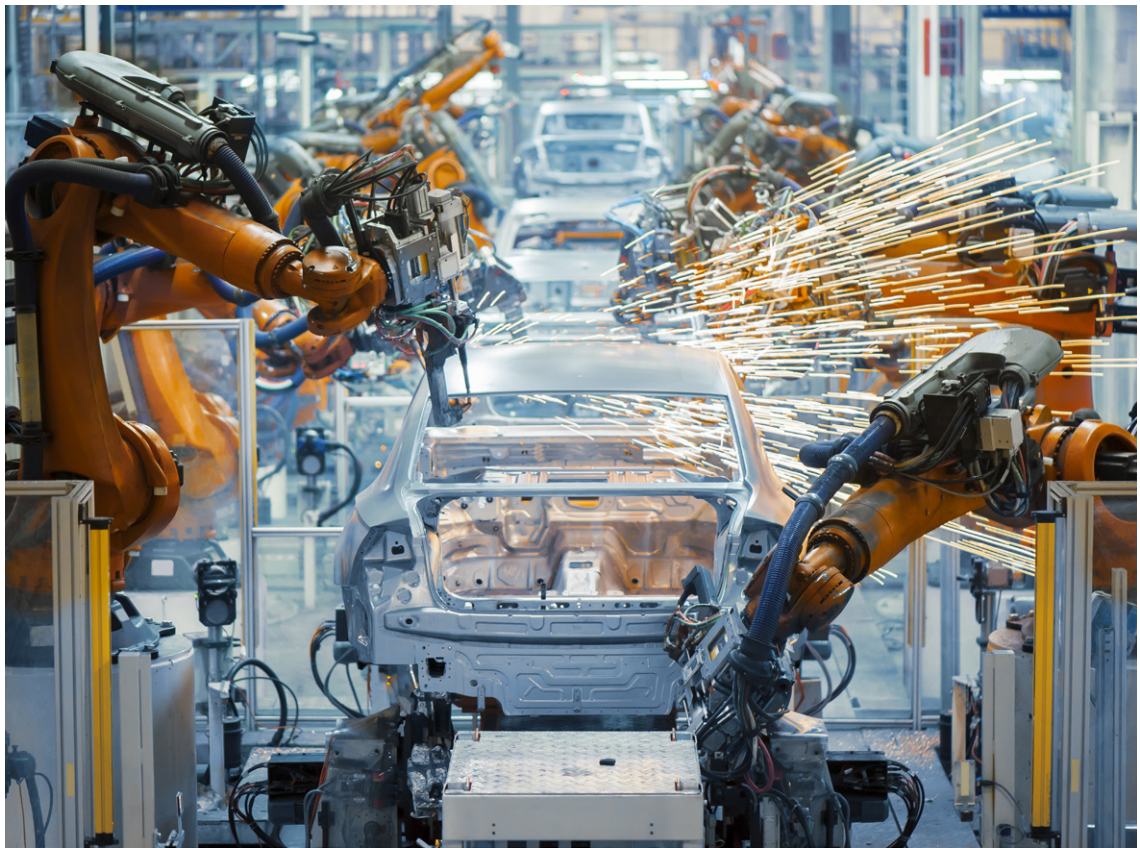
During the first 4 years from the effective date of the PR-IC (*ie*, July 1, 2019 to June 30, 2023), businesses engaged in the manufacturing of products for sale outside PR that were ineligible to obtain a tax Decree under prior manufacturing tax incentives laws or under the PR-IC may obtain a Decree subject to a 25 percent effective incremental application of the 4 percent income tax rate during the first 3 years of operation.<sup>4</sup>

A Decree issued to an Exempt Business engaged in Manufacturing Activities will generally provide the following tax benefits, in addition to those listed in Section II above:

- 4 percent income tax rate. However, the income tax rate is 8 percent income tax rate if the Exempt Business is subject to a 2 percent reduced withholding rate on royalties described in 3, below
- 4 percent capital gains tax rate on the sale or exchange during the term of the Decree of: (i) the shares/membership interests or (ii) all or substantially all of the assets, of the Exempt Business
- 12 percent income tax withholding on royalty payments made to non-PR resident entities or persons for the use, or right to use certain intangible property in Puerto Rico in connection with the Exempt Activities, unless the 2 percent withholding rate were to apply
- 100 percent income tax exemption on liquidating distributions
- Current deduction for amounts incurred for the purchase, acquisition or construction of machinery and equipment, construction of buildings and structures
- Subject to certain limitations, a nonrefundable and nontransferable income tax credit that can be claimed against the 4 percent or 8 percent income tax in an amount equal to the applicable withholding rate on royalty payments made to foreign persons (*ie*, 12 percent or 2 percent of the royalty payments)

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<sup>4</sup> That is, 25 percent in year 1, 50 percent in year 2, 75 percent in year 3 and the full 4 percent will be available in year 4 and thereafter.



- 100 percent income tax and MLT exemption on the income from certain investments related to certain activities in Puerto Rico
- 100 percent Construction Tax exemption on the construction works to be used in the Exempt Activities, which exemption is extended to contractors and subcontractors engaged for the construction work
- 100 percent excise tax and sales and use tax (SUT) exemption on certain items, including raw materials, machinery, equipment, accessories and spare parts, and the fuel purchased for the generation of thermal or electric power (including natural gas and propane gas), used in the Exempt Activities and
- A 25 percent non-transferable tax credit for the purchase of products manufactured in Puerto Rico (PR-Products Credit) and a transferable tax credit equal to 50 percent of the eligible investment made for research and development activities in Puerto Rico (R&D Credit).

Although the PR-IC provides for 100 percent exemption on real and personal property during the construction-in-progress period, the provisions relating to Manufacturing Activities provide that an Exempt Businesses engaged in Manufacturing Activities will enjoy 75 percent instead of 100 percent exemption.

No guidance has been provided on the DDEC's position on which exemption will effectively apply during the construction-in-progress period for this type of Exempt Activity. Thus, DDEC's Incentives Office should be consulted in this regard until official guidance from DDEC is issued. Nonetheless, an Exempt Business that is engaged in Manufacturing Activities can elect to self-assess their machinery and equipment that is treated as real property so that the real property taxes are imposed on the higher of 35 percent of the depreciated book value of the property, or the applicable statutory minimum value.<sup>5</sup>

<sup>5</sup> The PR-IC provides that the minimum values for this type property decreases from 25 percent to 10 percent depending on the property's useful life.

## V. Hotel and hospitality industry

The PR-IC provides tax benefits in connection with the establishment of certain tourism-development projects throughout Puerto Rico (Eligible Tourism Activities).

The following business activities generally qualify as Eligible Tourism Activities:

- Ownership or operation of: (i) hotels (including the operations of casinos), condohotels, Puerto Rican hostels, agro-housing, guesthouses, vacation clubs, guest houses from the Posadas de Puerto Rico program, those certified as bed and breakfasts and any other accommodation that forms part of the programs of the DDEC's Tourism Office; ownership of timeshare and/or vacation rights will be considered an Eligible Tourism Activity only if the owner is the creator developer or successor developer per Act 204-2016; and (ii) theme parks, golf courses operated by or in association with a hotel that is an Exempt Business or a golf course that is part of a resort, tourist marinas, port facilities for tourism purposes, agrotourism, nautical tourism, medical tourism and other facilities or activities that, due to the special appeal derived from their usefulness as a source of active or passive entertainment will promote internal or external tourism, and any other sector of tourism determined by the Tourism Office to be necessary and convenient for the development of tourism in Puerto Rico
  - Rental/leasing to an Exempt Business of property used in the Eligible Tourism Activities mentioned in item 1 above, except for financial leases
  - The development and administration of (i) sustainable tourism and ecotourism businesses, as provided in Act 254-2006 and (ii) natural resources that are considered a source of entertainment, including but not limited to caves, lakes, forests, or natural reserves, as determined by DDEC's Secretary to be necessary and convenient for the development of tourism in Puerto Rico and
  - eSports and fantasy leagues activities.
- Before requesting a Decree, the applicant must first hold a pre-application conference with the Tourism Office to discuss all matters related to the intended tourism activities, including the project's total estimated costs and tax credits available as a result of investment in the tourism project. Once the Decree is issued, the Exempt Business will generally enjoy the following tax benefits, in addition to those listed in Section II above:
- 4 percent capital gains tax on the sale or exchange of (i) the shares/membership interests or (ii) all or substantially all of the assets, of the Exempt Business, if the property continues to be used in the Eligible Tourism Activity for at least 24 months after the sale or exchange
  - 12 percent income tax withholding on royalty payments made to non-Puerto Rican resident entities or persons for the use, or right to use certain intangible property in Puerto Rico in connection with Eligible Tourism Activities
  - 100 percent property tax exemption on the stock or membership interests in the Exempt Business
  - 100 percent excise tax and SUT exemption on articles acquired and used by the Exempt Business in Eligible Tourism Activities, including those acquired by contractors or subcontractors of the exempt business in construction works related to the activity of the Exempt Business, excluding inventory for sale in the ordinary course of business
  - 100 percent exemption from crude oil excise taxes on the fuel purchased for generation of electric or thermal power for use by the Exempt Business in its Eligible Tourism Activities, including oil-derived products, natural gas and propane gas, but this exemption does not apply to residual fuel No. 6 or bunker C





- A transferable tax credit equal to 30 percent or 40 percent the eligible investment by an Exempt Business for the development and construction of property to be used in the Eligible Tourism Activities
- 90 percent exemption from all expenses and charges required by law or regulation, including taxes, internal revenue stamps, legal assistance stamps and recording fees, related to the execution of a deed required, and the issuance of a certified copy of said deed, and its subsequent filing and recordation in the Puerto Rico Registry of the property, in connection with real property used in the Eligible Tourism Activities and
- 100 percent income tax and MLT exemption for interest derived by a lender of funds used for the development and construction of property to be used in the Eligible Tourism Activities.

## VI. Banking and financing

Entities that intend to operate under the provisions of the International Financial Center Regulatory Act, or Act 273-2012 (Act 273), must obtain a Decree under the PR-IC, but they will continue to be subject to, and regulated by Act 273, which was enacted to promote Puerto Rico as a financial industry hub.<sup>6</sup> In this context, the Exempt Business will be required to obtain an international financial entity (IFE) license from Office of the Commissioner of Financial Institutions (OCIF, for its Spanish acronym), which will require the entity to comply and operate with the requirements of Act 273. Once the IFE license has been issued, the IFE can submit an application to request and obtain a Decree to enjoy the tax benefits provided by the PR-IC.

In addition to the tax benefits listed in Section II above, as applicable, distributions of earnings and profits, interest and financing charges from an IFE to non-PR Residents or IRIs (as defined in Section XI below) will be 100 percent exempt from income taxes, while dividend distributions to PR Residents other than IRIs will be subject to a 6 percent income tax.

For a more detailed discussion of these incentives, please refer to our publication *Understanding, organizing and licensing International Financial Entities in Puerto Rico*.



<sup>6</sup> Before the enactment of the PR-IC, Act 273 offered certain incentives to financial institutions that provide services to foreign persons, some of which were limited under the PR-IC when compared to those initially offered under Act 273.



## VII. International insurers

Under the PR-IC, entities that intend to operate under the International Insurers and Reinsurers Chapter of the PR Insurance Code, Act No. 77 of June 19, 1957 (Act 77), can request and obtain Decree to enjoy the tax incentives provided by the PR-IC. Nonetheless, an international insurance company operating under Act 77 (International Insurer) will continue to be subject to and regulated under Act 77, which was incorporated into Act 77 to promote the export of insurance and reinsurance services in markets outside of Puerto Rico.

Generally, although an International Insurer only insures risks outside of Puerto Rico, it may also be authorized to provide surplus lines coverage and reinsurance for risks located in Puerto Rico. To obtain a Decree as an International Insurer, the entity must first request and obtain a certificate of authority to the PR Insurance Commissioner's Office.

A International Insurer covered by a Decree will enjoy the following tax benefits, in addition to those listed in Section II above:





## VIII. Private equity funds

The PR-IC also contemplates the establishment of private equity funds (PEFs) as an Exempt Activity with two targets: promote investment in entities that do not have access to public capital markets and attract capital investments to Puerto Rico. See also our publication *Private equity and hedge funds in Puerto Rico – key tax considerations* for additional information regarding existing PEFs operating under Act 185-2014.

In general, the PR-IC provides that to be eligible for the tax benefits available for PEFs any limited liability company (LLC) or partnership – domestic or foreign – engaged in the business of investing in notes (including loans), bonds, shares of stock or similar securities (not traded in public markets when acquired) may elect to be treated as a PEF. Among other requirements, the LLC or partnership will have to establish an office in Puerto Rico and engage a registered investment advisor that is engaged in a trade or business in Puerto Rico.

In general, a PEF and/or its members or partners, will enjoy the following tax benefits, in addition to those listed in Section II above:

- The PEF will be treated as a partnership and, therefore, will not be subject to Puerto Rican income taxes; instead, its investors will be subject to Puerto Rican income taxes on their distributive share of the income derived by the PEF
- Investors will be subject to a 10 percent income tax rate on the distributive share of income from the PEF attributable to taxable interest and taxable dividends, while managing investors, and the investment advisors to the PEF, will be subject to Puerto Rico's 5 percent income tax rate. If the investor is not a Puerto Rico resident individual or corporation, it will only be subject to the 10 percent tax if such investors are obligated to pay income taxes in Puerto Rico.

However, members or partners of the PEF that are IRIs (See, Section XII below) will not be subject to the 10 percent tax imposed on interest and dividends if the income is derived before January 1, 2036

- Investors will enjoy 100 percent Puerto Rican income tax exemption on capital gains flowing from the PEF, while managing investors, and the investment advisors to the PEF, will enjoy a 2.5 percent Puerto Rican income tax rate
- Investors, managing investors, and the investment advisors to the PEF, will enjoy a 5 percent Puerto Rican income tax rate on the capital gain derived from the sale of membership interests in the PEF, unless the total proceeds from the sale are reinvested within 90 days in another PEF, in which case the gain will be 100 percent exempt from Puerto Rican income tax. However, a capital gain derived from the sale of membership interests in the PEF by an IRI (See, Section XII below) will not be subject to Puerto Rican income tax if the membership interests were acquired after the IRI became a resident of Puerto Rico and the gain is recognized before January 1, 2036
- 30 percent deduction (or 60 percent in the case of a PEF that is considered a Puerto Rican PEF) of the adjusted basis of its private capital investment in the PEF, subject to certain annual net income limitations
- 100 percent MLT exemption for the PEF and the investors.

## IX. Energy generation

The PR-IC offers incentives for businesses engaged in green energy related activities in Puerto Rico. Green energy includes energy generated via wind, solar, geothermic, biomass, hydroelectric, thermal oceanic energy, energy generated from solid waste conversion, anaerobic digestion, waste heat and fuel cells, among others.

Electricity generated from non-green energy sources and that qualifies as “highly-efficient generation” may be eligible for certain tax benefits if a Decree covering such activities is requested during a 5-year window from the effective date of the PR-IC (ie, July 1, 2019 to June 30, 2024). The term “highly-efficient generation” is defined as electric power generation in which at least 60 percent is generated in a highly efficient manner, as established by the Puerto Rico Energy Bureau (PREB) in Article 6.29(a) of Act 57-2014, in the case of electric power plants operated by the Puerto Rico Electric Power Authority (PREPA) or its successor, or third parties selling power to PREPA or its successor.

In the case of other power generators in Puerto Rico, highly-efficient generation follows the energy generation efficiency standards established by PREB in Article 6.29(a) and (b) of Act 57-2014 or any other industry-established parameter that guarantees efficient energy generation.

Combined heat and power plants must comply with the efficiency standards of the Federal Energy Regulatory Commission for qualified cogeneration facilities as issued in 18 C.F.R. § 292.205(a)(2)(i) and (d)(1)-(3), which will apply to facilities using natural or propane gas.

An entity engaged under Act 120-2018, also known as the Act to Transform Puerto Rico’s Electric System, may also be eligible for the tax benefits available to Exempt Businesses engaged in the generation of highly-efficient energy or the tax treatment provided to an entity that entered into a P3 agreement, as explained in Section XVII below.

The following are the energy generating Exempt Activities that would be covered by a Decree under the PR-IC:

- Production or sale of green or highly-efficient energy on a commercial scale for consumption in Puerto Rico, either as owner or as operator of the production unit
- Assembly and/or installation in a user’s facility of a green energy production unit or a highly-efficient generation system
- Leasing of property dedicated to green energy or highly-efficient energy production, including the rental of property to a business engaged in the production of green energy or highly-efficient energy.

To enjoy the tax benefits available for energy generation, the applicant must be certified as a power company by PREB before beginning operations.

Once a Decree has been obtained, the Exempt Business will generally enjoy the following tax benefits, in addition to those listed in Section II above:

- 4 percent capital gains tax on the sale or exchange of: (i) the shares/membership interests or (ii) all or substantially all of the assets, of the Exempt Business
- 12 percent income tax withholding on royalty payments made to non-Puerto Rican resident entities or persons for the use, or right to use certain intangible property in Puerto Rico in connection with the Exempt Activities
- 100 percent income tax exemption on liquidating distributions
- 100 percent real property tax exemption during the first fiscal year of operations of the Exempt Business

- 100 percent excise tax and SUT exemption on certain items including raw materials (such as natural gas and propane gas), machinery, equipment, accessories and spare parts, and the fuel purchased for the generation of green or highly-efficient energy used in the Exempt Activities
- 100 percent income tax and MLT exemption for interest derived by a lender of funds used for the development and construction of property to be used in the Exempt Activities
- Current deduction for amounts incurred for the purchase, acquisition or construction of machinery and equipment, construction of buildings and structures.

An Exempt Business engaged in green energy production will generate Renewable Energy Certificates (RECs), which are tangible assets with marketable economic value and which may be sold, transferred, negotiated or conveyed and is equivalent to 1 MW of electricity from a specific energy source (*ie*, green energy or highly-efficient energy).

The income generated from the sale of RECs that, in turn, are generated from Exempt Activities in Puerto Rico will be subject to the 4 percent income tax rate provided by the PR-IC, but will not be subject to MLTs or other municipal taxes. However, the gain on the sale RECs purchased will be subject to capital gain treatment, but not to MLTs or other municipal taxes. Note that a person engaged in the active business of purchasing and selling RECs will not be afforded this tax treatment.





## X. Infrastructure projects

To promote the development, restoration, rehabilitation or construction of infrastructure projects, including Puerto Rican historical zones, social interest housing, elderly and housing, and assisted living for the elderly and persons with disabilities (collectively, Infrastructure Projects), an Exempt Business may obtain a Decree for these type of Exempt Activities for a period of 5, 10 or 15 years, depending on the type of Infrastructure Project to be undertaken.

Once a Decree has been obtained, the Exempt Business will generally enjoy the following tax benefits, in addition to those listed in Section II above:

- 4 percent income tax rate on (i) rental income on buildings located in Historic Zones, (ii) income from the sale of social interest housing and housing for the elderly and persons with disabilities, (iii) rental from certain multifamily social interest housing, and (iv) income from assisted living projects for the elderly and persons with disabilities and construction of elderly housing for rental <sup>7</sup>
- Dividends will be subject to the income tax rules of Puerto Rico Internal Revenue Code of 2011 (PR-IRC)
- 90 percent exemption from municipal taxes or fees, including MLTs, on the rental income earned by the Infrastructure Project, except for rental income from property located in a Puerto Rican historical zone
- A 90 percent or 100 percent real and personal property tax exemption on real property used for the Infrastructure Project in the Exempt Activities and
- 75 percent Construction Tax exemption Infrastructure Projects, other than Infrastructure Projects developed to lease housing to low-income elderly persons.<sup>8</sup>



<sup>7</sup> The amount of gain that will be eligible for the 4 percent rate is equal to 15 percent of the sales price of a unit that is sold or, in the case of a rented unit, 15 percent of the fair market value of the unit.

<sup>8</sup> The PR-IC contains inconsistent provisions regarding the applicability of the 75 percent municipal Construction Tax exemption to Infrastructure Projects developed to lease housing to low-income elderly persons (Elderly-Housing Project). Section 2072.03(b) provides that an Elderly-Housing Project will not enjoy any Construction Tax exemption. Conversely, in Section 2072.03(e), which appears to be the general Construction Tax exemption provision for Infrastructure Projects, the PR-IC provides that Exempt Businesses (which should be those covered by the PR-IC Infrastructure Projects provisions, among others), their contractors and subcontractors will enjoy the 75 percent Construction Tax exemption. No guidance has been provided on the DDEC's position on which exemption should be effectively applied to this type of Exempt Activity. Thus, DDEC's Incentives Office should be consulted in this regard until official guidance from DDEC is issued.

## XI. Export services and foreign trade sales

The PR-IC continues to promote the export of services (Export Services) or the sale of products to foreign markets (Foreign Trade Sales), from Puerto Rico to persons outside of Puerto Rico and with no nexus /with Puerto Rico, that were previously provided under Act 20-2012 (commonly referred to as Act 20). Exempt Businesses engaged in Export Services or Foreign Trade Sales must also comply, with at least one direct full-time employee if its actual or projected gross income exceeds \$3 million, among other conditions.

Export Services or Foreign Trade Sales activities under the PR-IC (collectively the Eligible Export Activities) are the following:

### Export services

- Research and development
- Advertisement and public relations
- Consulting on economic, environmental, technological, scientific, managerial, marketing, human resources, information technology, auditing and matters related to any industry or business
- Call centers
- Blockchain and cloud-computing services, including subscription fees and other related charges
- Voice, video, audio and data telecommunication to persons located outside of Puerto Rico
- Centralized management and/or shared services
- Creative industries, including the sale of ticket outside Puerto Rico and the sale of tickets purchased by tourists in Puerto Rico, as well as income related to the transmission or sale of recording rights for audiences outside Puerto Rico, and shows and musical productions as well as eSports and Fantasy Leagues events to be held in Puerto Rico



- Investment banking, asset management and other financial services
- Hospital and laboratory services, including medical tourism and telemedicine facilities
- Professional services such as legal, tax, accounting, architectural and engineering services
- Software development
- Electronic information processing center
- Education and training
- Marketing centers
- Any other activity treated as an Export Services by the Secretary of DDEC in consultation with the Secretary of the Puerto Rico Department of the Treasury (PRDT), among many others.
- Sale or distribution of intangible goods/products including patents, copyrights, digital content, or trademarks, among others, to persons outside Puerto Rico storage, transportation and distribution of products and articles on behalf of third parties (hubs)
- Commercial distribution of products manufactured or grown in Puerto Rico to jurisdictions outside of Puerto Rico
- Assembly, bottling or packaging of products for export and
- Any other activity designated as a Foreign Trade Sales activity by regulation.

Foreign Trade Sales Exempt Businesses must generate at least 80 percent of their gross income from Foreign Trade Sales activities.

### Foreign trade sales

- Sale of products purchased by the Exempt Business for sale to foreign persons, for their use, consumption or disposition outside of Puerto Rico
- Commissions derived from the sale of products to foreign persons, for their use, consumption or disposition outside of Puerto Rico

An Eligible Export Activities Decree will provide the tax benefits listed in Section II above, and will require 12 percent income tax withholding on royalty payments made to non-Puerto Rican resident entities or persons for the use, or right to use certain intangible property in Puerto Rico in connection with the Exempt Activities.





## XII. Incentives for individuals

As part of Puerto Rico's initiatives to attract individuals to Puerto Rico, the PR-IC continues to provide specific tax incentives to individual resident investors (IRIs) which are similar to those previously granted under Act 22-2012 (commonly referred to as Act 22).<sup>9</sup>

To qualify as an IRI, the individual **must not** have been a Puerto Rican Resident between January 17, 2006 and January 17, 2012, and must become a Puerto Rican Resident no later than the taxable year ending on December 31, 2035. To enjoy the tax incentives, the IRI will be required to acquire a property that will become his or her principal residence in Puerto Rico within 2 years from the issuance of his or her Decree, and will be required to make an annual \$10,000 donation to Puerto Rico exempt nonprofit entities during the term of the Decree.

Subject to compliance with the eligibility requirements, DDEC generally will issue a Decree to an IRI granting the following tax incentives, available before January 1, 2036:

- 100 percent income tax exemption on all dividends, interest and net long-term capital gains resulting from the increase in value of securities and "other assets"<sup>10</sup> after the IRI becomes a Puerto Rican Resident and
- 5 percent income tax on net long-term capital gains resulting from the increase in value of securities and other assets held by the IRI prior to becoming a Puerto Rican Resident (the Non-PR Holding Period) and realized 10 years after the IRI became a Puerto Rican Resident (the PR Holding Period).<sup>11</sup>



<sup>9</sup> Although our discussion is centered in IRIs, hard-to-hire professionals, qualified physicians and eligible scientists or researchers, are also eligible for certain specific tax incentives under each category.

<sup>10</sup> The PR-IC defines the term "other assets" as commodities, currencies, and any digital asset based on blockchain technology.

<sup>11</sup> If the IRI sells the securities or other assets acquired before becoming a Puerto Rican Resident and the sale occurs before a 10-year period of becoming a Puerto Rican Resident, any long-term gain attributable to the Non-PR Holding Period would be subject to the regular capital gains tax rate in PR for individuals, which currently is 15 percent and up to a maximum 24 percent for alternate basic tax. The PR-IC provides that these gains would be treated as income from sources without Puerto Rico.

## XIII. Creative industries

The PR-IC covers film infrastructure projects, studio operators or postproduction studios and film projects generally for markets outside Puerto Rico, such as short films, feature films, documentaries, live productions such as beauty pageants, prize shows or similar shows, series, music videos, commercials, video games, as well as production and/or post-production of projects, among other productions.<sup>12</sup>



Once a Decree has been obtained, the Exempt Business will generally enjoy the following tax benefits, in addition to those listed in Section II above:

- 100 percent income tax exemption on liquidating distributions
- 100 percent MLT exemption
- 100 percent SUT exemption on articles used in the Exempt Activities
- 100 percent exemption from all expenses and charges required by law or regulation, including, taxes, internal revenue stamps, legal assistance stamps and recording fees, related to the execution of a deed required, and the issuance of a certified copy of said deed and its subsequent filing and recordation in the Puerto Rico Registry of the property, in connection with real property located in the Creative Industries Development Districts, as designated by DDEC and
- Special income tax credits in connection with Puerto Rican production costs that may range from 15 percent, 20 percent to 40 percent depending on the type and amount of Puerto Rican production costs incurred, subject to certain limitations.

Exempt Businesses engaged in air transportation services as public carriers will enjoy the following tax benefits:

- 100 percent income tax exemption on Puerto Rican income tax on the net income from Exempt Activities
- 100 percent real and personal property tax exemption on property used in the Exempt Activities and
- 100 percent Construction Tax exemption for the contractors and subcontractors of the Exempt Business.

<sup>12</sup> The minimum project investment amount for infrastructure projects is \$500,000, and the minimum investment for production and post-production projects ranges from at least \$25,000 to at least \$100,000, as applicable.

## XV. Puerto Rico opportunity zones

In addition to the capital gain deferral provided by the United States Internal Revenue Code of 1986 (US-IRC) and the PR-IRC qualified opportunity zones rules, the PR-IC offers tax benefits for investments in funds or business located in a qualified opportunity zone (QOZ) under the US Code. Puerto Rico's QOZ program (the Program) was designed to make investments in Puerto Rico under the US QOZ program more attractive to US investors while also allowing local Puerto Rican investors to participate in and benefit from the incentives granted pursuant to the Program.

Under a Decree, the Program provides the following tax benefits to qualified opportunity funds (QOFs) or qualified opportunity zone businesses (QOZB) as defined in the US-IRC<sup>13</sup> in which a QOF invests (*ie*, to be considered as an Exempt Business), in addition to those listed in Section II above:

- 18.5 percent income tax rate on net income from the QOF or QOZB Exempt Activities, whether the QOF or the QOZB are treated as partnerships
- 18.5 percent income tax withholding tax on royalty payments made to non-Puerto Rican resident entities or persons for the use, or right to use certain intangible property in Puerto Rico in connection with the QOF or QOZB Exempt Activities
- No gain or loss on the sale or exchange of assets during the term of the Decree, if the Exempt Business reinvests the proceeds realized on such sale or exchange in QOZ property



<sup>13</sup> A QOZB is a legal entity (*eg*, a corporation or partnership) in which a QOF invests and that meets the requirements imposed by the US-IRC to be treated as a QOZB.



- 25 percent exemption on MLTs, personal and real property taxes and Construction Taxes,<sup>14</sup> which exemptions can be increased up to 75 percent, by municipalities through municipal ordinances
- A transferable tax credit between 5 percent and 25 percent of the eligible investment made in an Exempt Business for investment in the Exempt Activities and
- 100 percent income tax and MLT exemption for interest derived by a lender of funds used for the development and construction of property to be used in the Exempt Activities.

To be eligible for the above tax benefits, the intended Exempt Business must be an eligible QOF or QOZB under the US Code provisions and regulations and the business activity must be a “priority project” in a QOZ designated within Puerto Rico, and it must also request and obtain a Decree. A priority project is a trade or business or activity that will contribute to Puerto Rico’s economic recovery, diversification and transformation.

The list of Exempt Activities considered to be a priority project is issued by the Puerto Ricangovernment, which list of activities will be valid for no less than 1 year from its publication (Exempt Activities List). The initial Exempt Activities List was published on August 19, 2019, which covered certain real estate related activities. As of the date of this publication, an updated Exempt Activities List has not been published.

Despite this, if a QOF or QOZB intends to undertake activities that are not otherwise in the Exempt Activities List, it will need to request a QOZ priority project designation to the Opportunity Zones Priority Project Committee, which is the governing body with the authority to publish and update the Exempt Activities List.



<sup>14</sup> The Construction Tax exemption is extended to contractors and subcontractors engaged for the construction work.

## XVI. Other exempt activities

The PR-IC also provides tax benefits to bona fide farmers, hard-to-hire professionals, qualified physicians and eligible scientists or researchers, certain entrepreneurial activities, as well as maritime transportation activities. The tax benefits for each of these Exempt Activities are subject to the eligibility requirements to obtain a Decree in connection with the applicable Exempt Activity.





## XVII. Tax treatment of P3s

Act 29-2009, also known as the Public-Private Partnership Act of 2009 (P3 Act), was enacted with the goal of attracting investments for projects that would improve Puerto Rico's infrastructure. The P3 Act and its regulation comprise one of the most robust legal frameworks for P3s in the Americas.

The P3 Act created the Puerto Rico Public-Private Partnership Authority as a public corporation and affiliate of the Government Development Bank for Puerto Rico. The P3 Act sets out certain areas, called "Priority Projects," where P3s are to be expressly authorized as a matter of public policy. These cover a broad range of construction, operation and maintenance projects, among them reservoirs and dams, energy plants, tourist and sports facilities, and wireless communication networks.

The entity entering into a P3 agreement with a government agency (Concessionaire) will enjoy a 20 percent income tax rate on the net income from the operations covered by the P3 agreement, and 100 percent income tax exemption on dividends or benefits distributions from said net income of the Concessionaire.





## About us

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