



Understanding, organizing and licensing  
International Financial Entities  
in Puerto Rico  
*A DLA Piper handbook*

# Understanding, organizing and licensing International Financial Entities in Puerto Rico

International Financial Entities (IFE) are licensed and regulated by the Office of the Commissioner of Financial Institutions of Puerto Rico) pursuant to Act No. 273 of September 25, 2012, as amended (the IFE Act) and Regulation No. 5653. The IFE Act, which replaces the International Banking Entities under the International Banking Regulatory Act, Act No. 52 of 1989, offers tax incentives to IFEs that set up operations in Puerto Rico, subject to the licensing requirement and regulatory powers of the Commissioner. These tax benefits are currently codified in Act 60-2019, better known as the Puerto Rico Tax Incentives Code.

In recent years, fintech companies have been established as IFEs in Puerto Rico's payments and money transfer business sector as well as in the cryptocurrency sector. IFEs also continue to be organized to provide traditional banking services such as deposits, lending, investments, trust services and other financial services.

In this handbook, we summarize the applicable laws and regulations governing the establishment of IFEs in Puerto Rico that may be of interest to those seeking a general understanding of the organization and licensing process, as well as the tax benefits offered under the IFE Act.

Please enjoy. We are pleased to assist you in learning more about the IFE process.



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# IFEs aim to attract US and foreign investors to Puerto Rico: the basics

The principal goal of IFEs is to attract United States and foreign investors to Puerto Rico. The IFE Act authorizes the proposed entity to engage in specific banking and financial activity from Puerto Rico (Authorized IFE Activities) with non-residents of Puerto Rico. Puerto Rico residents are allowed some activities, but those are the exception. The Authorized IFE Activities are listed in the Appendix to this document. Pursuant to the IFE Act, any person other than an individual, incorporated or organized under the laws of Puerto Rico, the United States or any other country, or any entity constituted as a unit of said person, may apply for a license to do business as an IFE.

An IFE does not have to be a bank (an entity that accept deposits and lends money) but it can be set up as one. IFEs can be set up as lending companies, traditional banks, payment services companies, investment advisors and investment management firms among other providers of financial services.

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IFEs that are authorized to accept deposits are regarded as depository institutions or banks, and there is a heightened level of regulation related to these types of IFEs given that one of the main concerns of the Commissioner of Financial Institutions (the Commissioner) is the protection of depositors. In connection with these types of IFEs, the Commissioner requires higher levels of capitalization and compliance.

An IFE organized pursuant to the provisions of the IFE Act must have (i) at least four full-time employees that are residents of Puerto Rico; (ii) physical presence and office space in Puerto Rico; (iii) authorized capital stock of no less than US\$5 million, with at least US\$250,000 of paid-in-capital at the time the license is issued; and (iv) in addition to the paid-in capital minimum described in (iii) above, US\$300,000 of unencumbered assets or acceptable financial securities, or a lesser amount as authorized by the Commissioner, at its sole discretion. The IFE Act requires each IFE to maintain these unencumbered assets at all times.

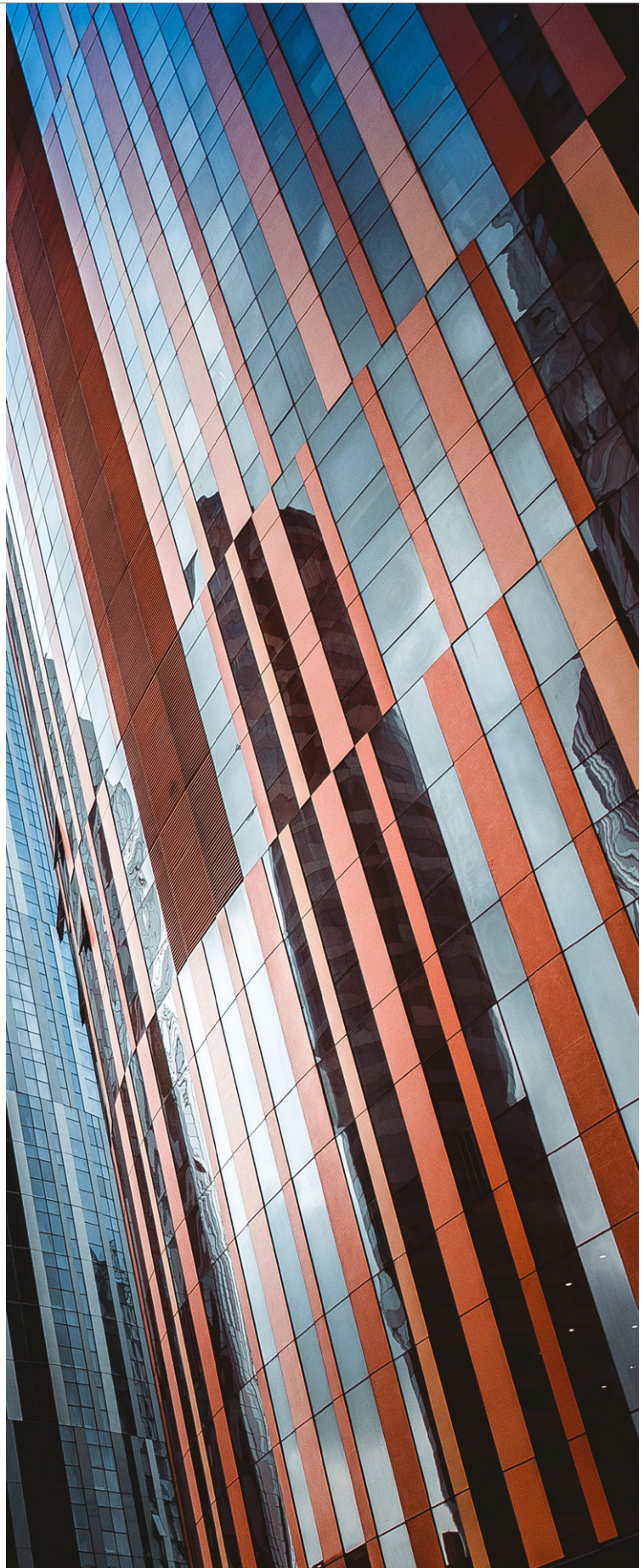
IFEs that are authorized to accept deposits are typically subject to capital requirements similar to those applicable to commercial banks in the United States that have their deposits insured by the Federal Deposit Insurance Corporation (FDIC).

In addition to that, although it is not required by the IFE Act, as a matter of policy, the Commissioner is requesting that IFE applicants show a paid-in capital of at least US\$5 million or a capital plan showing how the IFE will reach that level of capitalization within a stated period of time consistent with the financial projections submitted to the Commissioner with the IFE license application.



In order to operate as an IFE under the laws of the Commonwealth of Puerto Rico, the entity must first be organized as a corporation, partnership, limited liability company or other legal entity. In order to organize an IFE, the applicant must first draft the articles of incorporation, partnership agreement, operating agreement or any other applicable organizational documents establishing the IFE.

Said organizational documents must contain (i) the name of the IFE, which must include the words "International," "Foreign," or "Overseas," or other similar words connoting the international character of the IFE; (ii) the address of the principal place of business in Puerto Rico of the IFE; (iii) the authorized or proposed capital of the IFE (as described above); (iv) the term of existence of the IFE; and (v) the purposes for which it is organized, including a specific limitation of its operations to carry out only those services authorized by the IFE Act.



# The application process

The application process to establish an IFE consists of two stages.



**The first stage** of the process encompasses the organization of the IFE and begins once the organizational documents have been drafted and the applicant files an application for a permit to organize with the Commissioner. This application must be in writing, sworn before a notary public (and apostilled if notarized outside of Puerto Rico), and must include (i) drafts of the proposed organizational documents establishing the IFE; (ii) a business plan; (iii) a nonrefundable application fee of US\$5,000; (iv) background checks and historical and financial information of the persons who directly or indirectly propose to own or control ten percent or more of the capital of the IFE and of the proposed directors and officers of the IFE; and (v) the number of proposed employees of the IFE (as described above).

Background checks are to be performed by third-party companies pre-approved by the Commissioner. These third parties provide such reports directly to the Commissioner for review.

Individuals who are required to provide financial statements must provide a balance sheet of the individuals' net assets (assets and liabilities) certified by certified public accountants or similar professionals, depending on the jurisdiction of the individual. After the application for a permit to organize is duly filed, the Commissioner shall analyze and investigate the filed application and all other additional documents deemed relevant.



**The second stage** of the application process begins once the permit to organize the IFE is issued. At that time, the applicant must have filed (i) the organizational documents and (ii) a copy of the permit to organize with the Puerto Rico State Department (PRSD).

The permit to organize shall be in effect for a period 6 months from the date it is issued by the Commissioner. After the entity has been organized, offices leased or acquired, and capital contributed to the entity, the applicant may file for the permit to commence operations and the issuance of the IFE license.



# Documentation

The Commissioner may grant, conditionally grant or deny the final license application based upon consideration of the following documents:

1. A certification issued by the PRSD, under its official seal, specifying that the organizational documents and the copy of the Permit to Organize have been duly filed
2. The payment of a license fee in the amount of US\$5,000, in the form of a money order, official check or certified check payable to the order of the Secretary of the Treasury of Puerto Rico
3. A certified copy of all documents filed at the PRSD
4. Copy of the regulations or by-laws adopted by the Board of Directors or governing body of the IFE, certified by the secretary or authorized person, before notary public
5. Evidence showing the principal place of business
6. Evidence that the paid-in capital of the IFE has been subscribed, issued and paid, and that the IFE complies with the requirement regarding maintaining unencumbered assets (as discussed above)
7. A statement or certificate of corporate resolution, certified by the secretary or authorized person, before notary public, indicating that the IFE has complied with all the provisions of the Act and Regulation 5653 and that it is ready to commence operations and
8. A sworn statement signed by the chief executive officer of the institution, certifying that the entity has adopted and will implement the procedures and systems necessary and adequate to comply with the Bank Secrecy Act and regulations issued thereunder and that it has adopted or will adopt the policies and procedures necessary to comply with all OFAC requirements.



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# Tax benefits

After an IFE license is issued by the Commissioner, a copy of the same must be filed with the PRSD no later than 10 days from the date of issuance. Thereafter, the IFE may request a tax exemption grant from the Puerto Rico Department of Economic Development and Commerce (DDEC, for its Spanish acronym). In the event the tax exemption grant is issued, the effectiveness of such tax grant is retroactive to the date of its filing.

Unlike IBEs, IFEs receive their preferential tax treatment through a tax grant, or a contract with the government, rather than by operation of law. The contractual protection of tax grants secures the tax benefits for a period of 15 years, and thus, cannot be repealed or modified by the Puerto Rico legislature. The 15-year period may be renewed. The extensions must be requested 6 to 24 months before the end of the applicable 15-year term.

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## *IFEs receive their preferential tax treatment through a tax grant, or a contract with the government*

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Under Subchapter A of Chapter 4 of Act 60-2019, as amended, better known as the Puerto Rico Tax Incentives Code (Act 60), both the IFE and its shareholders receive preferential tax treatment. The IFEs have the following tax benefits: (i) a fixed 4 percent income tax rate on the net income derived by the IFE from Authorized IFE Activities; (ii) 75 percent exemption on property tax and 50 percent exemption on municipal license tax on such activities; and (iii) full exclusion of interest, financing charges or participation in partnerships benefits, which will not be considered gross income from Puerto Rico sources and therefore will not be subject to taxation or withholding provisions for nonresidents of Puerto Rico.

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## *In an effort to attract more investors and further boost the Puerto Rico economy, the IFE Act can interact with Act 60*

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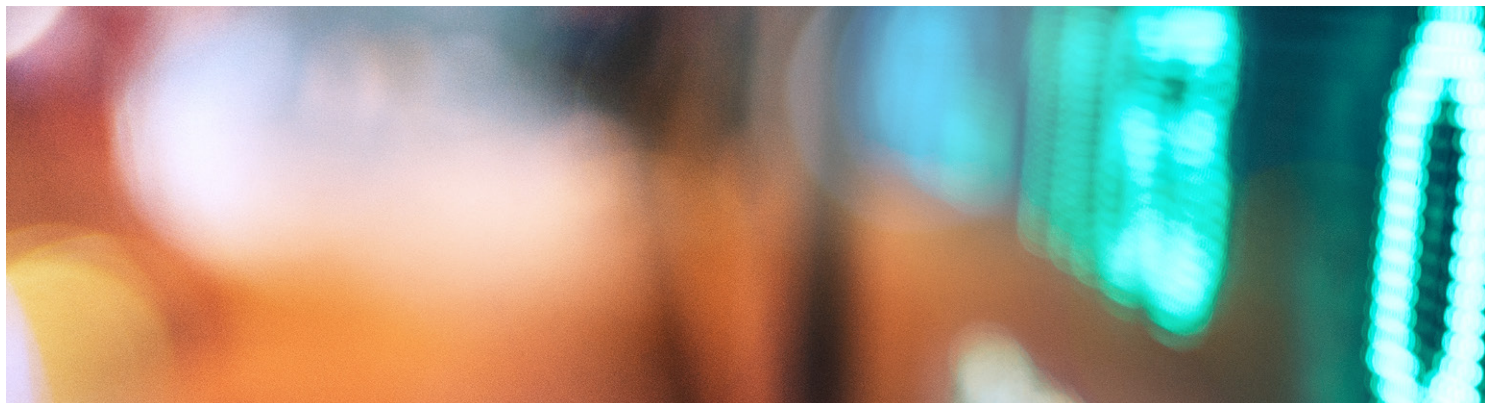
For shareholders, tax benefits include: (i) a 6 percent income tax rate on distributions to Puerto Rico resident shareholders of earnings and profits derived from Authorized IFE Activities; and (ii) full Puerto Rico income tax exemption on such distributions to non-PR-resident shareholders.

At the heart of these incentives is the potential interplay between the IFE Act and Act 60. In an effort to attract more investors and further boost the Puerto Rico economy, the IFE Act can interact with Act 60 so that dividends received by a bona fide PR resident from Authorized IFE Activities that are Puerto Rico source income are fully exempt from Puerto Rico income tax under Act 60 and are also exempt from US income tax pursuant to the US Internal Revenue Code of 1986, as amended.

## These nine factors are also relevant

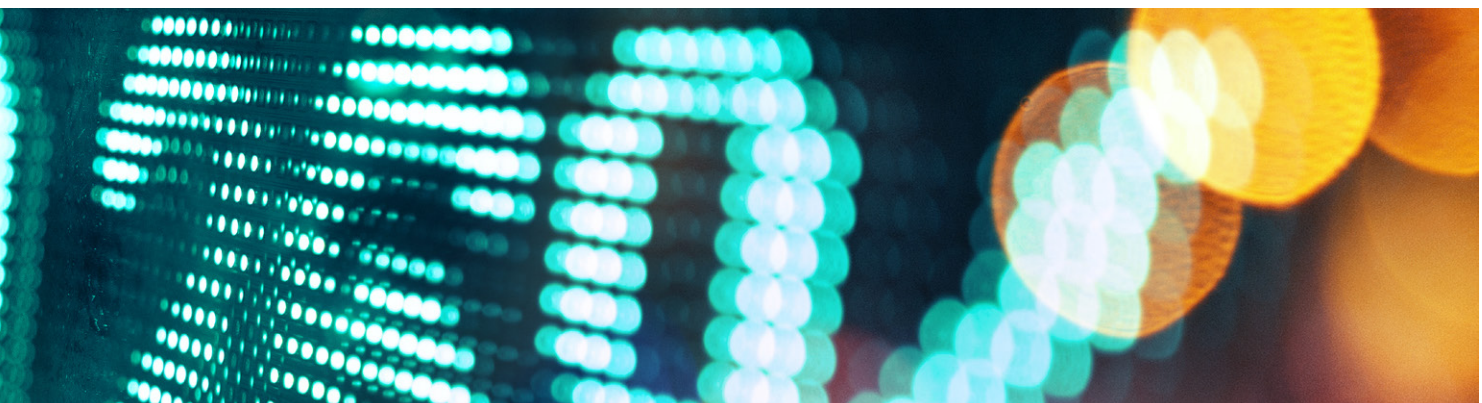
Finally, if you are considering applying for a license to do business as an IFE, the following may be of interest:

1. The IFE Act makes US anti-money laundering statutes such as the Bank Secrecy Act, the USA PATRIOT Act and OFAC pronouncements applicable to IFEs. Compliance with anti-money laundering statutes and regulations is of utmost importance to the Commissioner.
2. The Commissioner may not establish interest rates to be paid or payable to the IFE.
3. The IFE Act does not establish lending limits for IFEs, although for IFEs that are depository institutions having lending limit policies would be recommended as a safe and sound practice.
4. The IFE Act provides that all information submitted to the Commissioner regarding the IFE will be treated as confidential, and may not be revealed by the Commissioner, unless through a written court order from a court of competent jurisdiction or a formal order from a governmental agency in the course of its supervising powers of the IFE and when the Commissioner understands that such action is in the best public interest.
5. Certain IFEs which receive deposits may qualify as a "Territory Financial Institutions" for purposes of the Foreign Account Tax Compliance Act (FATCA). If that is the case, the IFE may not be obligated to provide information about its clients to the US Internal Revenue Service under FATCA.
6. Although the IFE Act includes activities such as securities brokerage/trading and investment advisory services as authorized activities, the IFE may be required to have additional licenses or registrations under the US Securities Exchange Act of 1934, as amended (1934 Act), the US Investment Advisers Act of 1940, as amended (1940 Act) and/or the Puerto Rico Uniform Securities Act, as amended (PRUSA). Said licenses or registrations depend on the type of activities the IFE is going to perform since there may be some exceptions and exemptions that may be applicable. The point here is that obtaining an IFE license does not exempt the entity from obtaining other licenses or registrations that may be required under other statutes such as the 1934 Act, the 1940 Act and the PRUSA. Notwithstanding the above, an IFE can offer securities brokerage/trading services to its clients through the IFEs duly authorized trust department and by using the services of duly registered securities broker dealers as long as the IFE does not charge commissions for trades, which are performed by the duly registered securities brokerage dealer.





7. The Federal Reserve Bank of New York (NY FED) has opened banking accounts for IFEs. In that sense the IFE becomes a client of the NY FED, which does not equate to becoming a member of the Federal Reserve System (the Fed) or being regulated by the Fed. In 2019, the NY FED issued a circular announcing that it was suspending approval of all new and pending applications for accounts and new services from international financial and banking entities in PR and the US Virgin Islands as a result “recent events,” including the expansion of economic sanctions to Venezuela, and stated that it would release “enhanced standards applicable to its provision of account and financial services, including minimum customer requirements and enhanced terms that will govern certain customers’ use of accounts of financial services, which includes IBEs and IFEs.” On February 25, 2020, the NY FED ended the suspension and pause period and published its Federal Reserve Bank of New York Account and Financial Services Handbook and Related Documentation, which includes the guidelines and requirements to apply and maintain an account at the NY FED.
8. As long as the IFE is not a banking subsidiary of a bank holding company under the US Bank Holding Company Act of 1956, as amended (BHCA), there is no requirement for the IFE to have its deposits insured by the FDIC. If on the other hand, the IFE engages in both deposit taking and lending activities in the United States, then the IFE could be considered as a banking subsidiary of a bank holding company under the BHCA. In that case the owner of the IFE, other than individual natural persons, and the affiliates of the IFE would be subject to the applicability of the BHCA, in addition to requiring the IFE to have its deposits insured by the FDIC.
9. IFE applicants that seek to organize IFEs to engage in financial activities related to blockchain technology and virtual currencies will have to follow the guidelines established by the Commissioner on April 12, 2018. Said guidelines follow similar statements issued by the Office of the Comptroller of the Currency in connection with Special Purpose National Bank Charters for Financial Technology Companies.



## Appendix: Authorized IFE activities

1. Upon authorization of the Commissioner, accept deposits from foreign persons in checking accounts, as well as demand or fixed term deposits, including interbank demand deposits and fund deposits, or otherwise borrow money from international financial institutions and any foreign person pursuant to the regulations of the Commissioner. Every IFE may borrow money on loan, provided, that said transactions are not tantamount to the acceptance of deposits.
2. Upon authorization of the Commissioner, accept properly collateralized deposits or otherwise borrow duly secured money from the Government Development Bank for Puerto Rico and the Economic Development Bank for Puerto Rico.
3. Make or place deposits in, and otherwise give money on loan to, the Government Development Bank for Puerto Rico, the Economic Development Bank for Puerto Rico, any international financial institution, or any bank, including banks organized under the laws of Puerto Rico, and branches in Puerto Rico of banks that are foreign persons.
4. Make, procure, place, guarantee, or service loans; none of such loans may be granted to a domestic person, with certain exceptions subject to the approval of the Commissioner.
5. (a) Issue, confirm, give notice, negotiate, or refinance letters of credit; provided, that the client and the beneficiary requesting the letter of credit is not a domestic person, or (b) issue, confirm, give notice, negotiate, or refinance letters of credit in transactions for the financing of exports, even if the beneficiary is a domestic person.
6. Discount, rediscount, deal or otherwise trade in money orders, bills of exchange, and similar instruments; provided, that the drawer and the original debtor is not a domestic person.
7. Invest in securities, stocks, notes, and bonds of the Government of Puerto Rico exempt from the payment of taxes in Puerto Rico.
8. Carry out any banking transactions allowed by the IFE Act in the currency of any country, or in gold or silver, and participate in foreign currency trade.
9. Underwrite, distribute, and otherwise trade in securities, notes, debt instruments, drafts, and bills of exchange issued by a foreign person for final purchase outside of Puerto Rico.
10. Engage in trade financing of import, export, barter and exchange of raw materials and finished products activities with domestic persons, when the Commissioner has determined through regulations, administrative determination, or order that the international aspects of the underlying transaction override any involvement of the local financial and business community, and that such activities would be appropriate for the international financial institution.
11. Engage in any activity of a financial nature outside of Puerto Rico which would be allowed to be done, directly or indirectly, by a bank holding company or by a foreign office or subsidiary of a United States bank under applicable United States law.
12. After obtaining a special permit from the Commissioner, act as fiduciary, executor, administrator, registrar of stocks and bonds, property custodian, assignee, trustee, attorney-in-fact, agent, or in any other fiduciary capacity; provided, that such fiduciary services shall not be offered to, nor inure to the benefit of domestic persons.
13. Acquire and lease personal property at the request of a lessee who is a foreign person, pursuant to a financial lease agreement that complies with the Regulations of the Commissioner.

14. Buy and sell securities outside of Puerto Rico, on the order of, or at its discretion, for foreign persons and provide investment advice in relation to such transactions or separate therefrom, to such persons.
15. Act as a clearinghouse in relation to financial contracts or instruments of foreign persons, as authorized by regulations adopted by the Commissioner.
16. Organize, manage, and provide management services to international financial institutions, and other types of financial entities located outside of Puerto Rico, such as investment companies and mutual funds, provided, that the stock or participation in the capital of such companies is not distributed directly by the international financial institution to domestic persons.
17. Engage in such other activities as are expressly authorized by the regulations or order of the Commissioner or are incidental to the execution of the services authorized by the IFE Act and the Regulations of the Commissioner, except those expressly prohibited by the IFE Act.
18. Participate in the granting and/or securing of loans that originate and/or are secured by the Government Development Bank for Puerto Rico and the Economic Development Bank for Puerto Rico.
19. (a) Finance, through loans or financial securities, projects in areas of priority for the Government of Puerto Rico in those cases designated as extraordinary by the Secretary of the Treasury and the Commissioner; and (b) in all cases, the prior authorization of such loans by the Secretary of the Treasury and the Commissioner shall be required.
20. Establish, upon authorization of the Commissioner, branches outside of Puerto Rico, in the continental United States and its possessions, or in other foreign countries; provided, that said branches do not accept any kind of deposit. The Commissioner is hereby empowered to prescribe, by regulations, the procedure to obtain said authorization, and the amount payable for application investigation expenses and annual quota fees for each one of said branches.
21. Upon authorization of the Commissioner, provide to other international financial institutions or to foreign persons outside of Puerto Rico, those services of a financial nature, as these are defined and generally accepted in the banking industry of the United States and Puerto Rico, and which are not listed in this list.
22. Engage in rendering of the following services: (i) asset management; (ii) alternative investment management; (iii) management of private capital investment activities; (iv) management of hedging funds or high-risk funds; (v) pools of capital management; (vi) administration of trusts that serve to convert different groups of assets into securities; and (vii) escrow accounts administration services; provided, that such services are offered to foreign persons.



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## Find out more

Learn more about becoming an IFE in Puerto Rico by contacting the authors:

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