

# Puerto Rico Export Services Tax Incentives

May 2012

PUERTO RICO  
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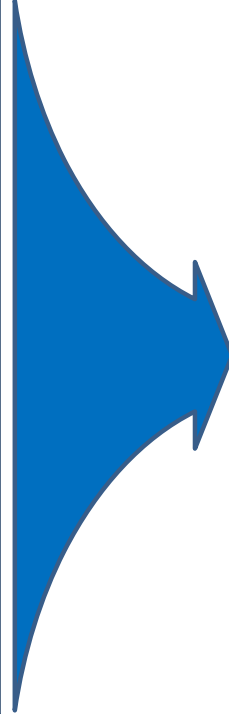


Act 20 of 2012 was signed into law on January 17, 2012

## Incentives for Export Services Businesses in Puerto Rico:

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- ✓ **4%** corporate tax rate
- ✓ **100%** tax exemption on dividends from export services businesses
- ✓ Decree of **20 years**, guaranteeing these rates
- ✓ **No federal taxes**



## Sample Export Services

- Research and Development
- Advertising and Public Relations
- Consulting
- Commercial Arts and Graphics
- Architecture and Engineering
- Legal, Tax and Accounting
- Education and Training
- Hospitals and Laboratories
- Investment Banking
- Asset Management

**1 Puerto Rico at a Glance**

**2 Act to Promote the Exportation of Services of 2012**

**3 Tax Savings and Other Considerations**

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## Strategic Location

- Serves as a gateway to the continental United States and Latin America
- Largest and busiest airport in the Caribbean
- Direct flights to many major cities, such as New York (3.5 hours), Miami (2.5 hours), Madrid and London



## Priviledged Location

- Ideal climate: Average temperature of 83°F in winter and 85°F in summer
- Variety of terrain: Coast, plains and mountains, including the only tropical rain forest in the U.S. National Forest System, El Yunque
- Great diversity of natural resources: Ranked among the top jurisdictions with the best beaches in the world





## We are part of U.S. = Benefits and protections for investment

- **Puerto Rico has many attributes to attract investment**
  - Applicability of the U.S. federal laws and presence of U.S. federal courts
  - Intellectual property protection under U.S. law
  - U.S. currency, and banking regulated under the U.S. system (FDIC)
  - Participation in the trade agreements of the U.S.
  - No U.S. passport required for U.S. citizens
  - Access to federal funds for infrastructure, social programs, education and research, among others



# Favorable Tax and Cost Structure

## A unique proposal for multinational corporations

- **Foreign tax structure**
  - There is no income tax at the federal level to residents of Puerto Rico
  - Tax treatment for Controlled Foreign Corporation (CFC), where federal income taxes for U.S. based multinational corporations are deferred until profits are repatriated to the U.S.
  - Favorable tax rates and incentives
- **Competitive costs compared to the U.S.**
  - The average cost of doing business in Puerto Rico is 10% lower than the U.S. average
  - San Juan offers the lowest costs of doing business of any major U.S. city





## Perfect for Doing Businesses

### New companies will find an attractive environment to do business

- **Business Friendly Environment**

- Puerto Rico has a strong yet flexible legal and regulatory framework, with all corporate law and regulations published in English

- **English Language**

- English and Spanish are the official languages of Puerto Rico, and English is widely spoken throughout the island

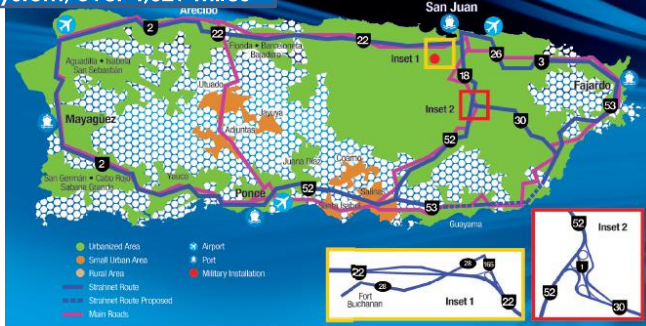
- **Highly Qualified Professionals**

- Puerto Rico boasts high standards of education, and has highly qualified professionals in all fields, including law, finance, engineering, etc.

“...among the best in Latin America & the Caribbean...” – Financial Times

## Extensive highway system, over 4,629 miles

Puerto Rico Major Roadways & Strahnet System



## Port of San Juan is the 8th busiest port in the U.S.

Puerto Rico's Port



## PR's air access is by far the best in the Caribbean

Puerto Rico's Airports



## SJU is the busiest airport in the Caribbean

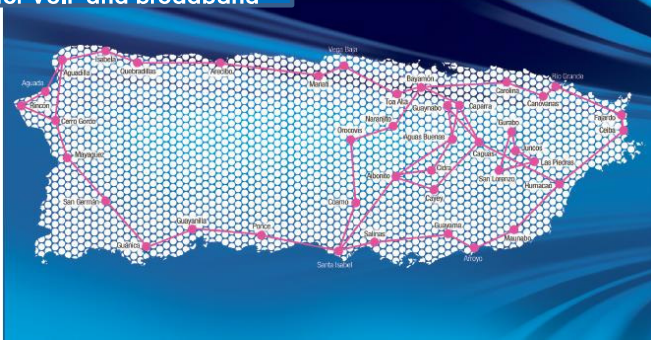
Puerto Rico's Air Access to the United States



## Modern and World Class

Outstanding infrastructure  
for VoIP and broadband

Fiber Optic Network



Over 1.8 million visitors in  
just 5 years

PR Convention Center



Urban Train - Over 40,000  
daily passengers



Over 3 million visitors in  
just 6 years

Coliseo de Puerto Rico



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## Act No. 20 of 2012 to Promote the Exportation of Services

### Act 20 of 2012

- **Objective:** To provide the appropriate environment and opportunities to make Puerto Rico a center of international services, focusing on:
  - encouraging local service providers to expand their business by offering their services to clients who are located outside of Puerto Rico, and
  - convincing foreign service providers to move their businesses to Puerto Rico
- **Public policy:** The development of a local service industry that is directed to the export of all kinds of services is declared as the public policy of the Government of Puerto Rico

## For Puerto Rico Export Services Businesses

### 4% Corporate Tax Rate

- Puerto Rican businesses providing services for exportation will enjoy a 4% flat income tax rate on income related to such services.
- This rate may be reduced to 3% when more than 90% of the eligible business's gross income is derived from export services and such services are considered "strategic services" as set forth under the Act.

### 100% Tax-Exempt Dividends

- Distributions from earnings and profits derived from the export services income of eligible businesses are 100% tax exempt for Puerto Rico residents.

### 100% Exemption on Property Taxes

- Eligible businesses providing services in the categories of corporate headquarters, call centers and shared services centers will enjoy a 100% exemption from property taxes during the first five years of operations.
- After said 5-year period, a 90% exemption will apply during the term remaining under the Tax Exemption Decree.



## Eligible Services

### The following are the services that are eligible for the new tax incentives

- **Research and development**
- **Advertising and public relations**
- **Consulting**
- **Advise on matters relating to any trade or business**
- **Commercial arts and graphic services**
- **Production of construction drawings, architectural and engineering services and project management**
- **Professional services, such as legal, tax and accounting**
- **Centralized management services**
- **Centers for electronic data processing**
- **Development of computer programs**
- **Telecommunications voice and data between persons located outside of Puerto Rico**
- **Call centers**
- **Shared services centers**
- **Storage and distribution centers**
- **Educational and training services**
- **Hospitals and laboratories**
- **Investment banking and other financial services**
- **Any other service that is later decided to be treated as an eligible service because it is in the best interest of Puerto Rico**

## Puerto Rican companies providing services abroad about non-Puerto Rican matters

### **Puerto Rico Businesses**

- The Act applies with respect to any entity with a bona fide office or establishment located in Puerto Rico that is or may be engaged in an eligible service.

### **Services for Exportation**

- Services must be performed for non-resident individuals and/or foreign entities that have no nexus with Puerto Rico.

### **No Nexus to Puerto Rico**

- The Eligible Service provided must not, and will not be, related to the conduct of a trade, business or other activity in Puerto Rico.



## Law provides special rules for promoters and for existing P.R. businesses

### Promoters

- **Special Incentive to Promoters:** The Act provides for incentives to local service providers that are engaged in Promotional Services.
- **Promotional Services** are eligible services rendered to non-Puerto Rico resident individuals and/or foreign entities related to the establishment of a New Business in Puerto Rico, as defined in the Act.
- **Tax incentives:** Businesses engaged in qualifying promotional services will receive the same tax incentives under the Act, but only with respect to the net income derived within the 12-month period prior to the New Business taking any of the following actions:
  - Beginning construction of the facilities to be used in Puerto Rico;
  - Commencing operations in Puerto Rico; or
  - Executing a contract to acquire or lease facilities in Puerto Rico.

### Existing Puerto Rico Businesses

- **Existing Puerto Rico Businesses** are encouraged to apply for the incentives under the Act if they engage or intend to engage in exporting any of the eligible services described or in Promotional Services.
- **Base Period:** For those existing Puerto Rico businesses, the tax incentives will only apply to that portion of net income derived from an eligible service that exceeds the average net income generated by such business during the three taxable years preceding the date a request for a Tax Exemption Decree is filed by such business (“**Base Period**”).



## Tax Exemption Decree

### Providing certainty for eligible businesses

- **Tax Exemption Decree:** To enjoy the benefits granted under the Export Services Act the services provider must request and obtain a tax exemption decree under the Act, which will be signed by the Secretary of the Department of Economic Development and Commerce of Puerto Rico.
- **20 Years:** Such decree will have term of 20 years, renewable for 10 additional years, provided certain conditions are satisfied.
- **Certainty:** The Tax Exemption Decree will constitute a contract with the Puerto Rico Government not subject to subsequent legislative changes.



# Obtaining a Tax Exemption Decree

## A fast and predictable process

- **Application:**
  - Interested persons may obtain a Tax Incentive Application from the Office of Industrial Tax Exemption.
  - The application is available on their website <http://www.oeci.pr.gov>.
  - Applicants must ensure that their initial application is complete and correct in all respects in order to avoid delays in the review process and the granting of the Tax Exemption Decree.
- **Interagency Review:**
  - The completed application will be reviewed by the relevant governmental departments and agencies.
  - They will ensure compliance with the applicable eligibility criteria, as set forth in the application and the Act.
- **Signed Decrees:**
  - The Secretary of Economic Development and Commerce will sign the Tax Exemption Decree for approved applications.
  - Applicants who submit a complete application should expect to have their Tax Exemption Decree in approximately **45 to 60 days**.

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# Lower Tax Rates than in the U.S.

## Compare the Puerto Rico Tax Rates to those in the U.S.

### Average U.S. Company

- Average State Corporate Tax Rate: 7%
- Federal Corporate Tax Rate: 35%

### Average U.S. Shareholder

- Average State Dividend Tax Rate: 6%
- Federal Qualified Dividend Tax Rate: 15%<sup>4</sup>



**Potential Increase in Rates with the Upcoming Expiration of Bush Tax Cuts**

### Export Services Company in P.R.

- Puerto Rico Corporate Tax Rate: 4%<sup>1</sup>
- Federal Corporate Tax Rate: 0%<sup>2</sup>

### P.R. Shareholder

- Puerto Rico Dividend Tax Rate: 0%<sup>3</sup>
- Federal Dividend Tax Rate: 0%<sup>2</sup>



**Certainty in Rates for 20 Years with Tax Exemption Decree**

<sup>1</sup> Municipalities in Puerto Rico may levy a gross receipts tax of up to 0.5% (1.5% for financial services), which applies in addition to the applicable corporate tax rate.  
<sup>2</sup> Puerto Rico companies and individual residents do not pay federal taxes on Puerto Rico source income.  
<sup>3</sup> Rate applies to shareholders of export services companies exempted under Act 20 who are residents of Puerto Rico.  
<sup>4</sup> This preferential rate is set to increase to as much as 39.6% after December 31, 2012.



# Incredible Corporate Tax Savings

## Sample savings

- **Assumptions:** Company X is a service provider that qualifies under the Act with \$10MM in gross revenues and \$2.5MM net income before taxes. Its current corporate state tax rate is 7% and its federal rate is 35%.
- **See the Savings:**

Company X in the U.S.	
• State Corporate Tax:	\$175,000
• Federal Corporate Tax:	<u>\$875,000</u>
• Total Tax:	\$1,050,000

Company X in Puerto Rico	
• Puerto Rico Corporate Tax:	\$100,000 <sup>1</sup>
• Federal Corporate Tax:	<u>\$0<sup>2</sup></u>
• Total Tax:	\$100,000

**Total Annual Savings: \$950,000**

<sup>1</sup> Assumes no gross receipt tax from Puerto Rico municipalities.

<sup>2</sup> Puerto Rico companies do not pay federal taxes on Puerto Rico source income.



# Savings on Dividends Too

## 100% tax-exempt profit distributions to Puerto Rico residents under Act 20

- **Assumptions:** Company X is the same as in the previous slide. It has a policy of distributing all of its net earnings to its shareholders, who are in the U.S., but can all move to Puerto Rico. Shareholders of Company X currently have a state income tax rate of 6% and a federal rate of 35% applicable to dividends.<sup>1</sup>
- **See the Savings if Company X and all of its Shareholders are in Puerto Rico**

Company X in the U.S. and Shareholders in the U.S.		Company X in Puerto Rico and all Shareholders in Puerto Rico	
• Net Income Before Taxes:	\$2,500,000	• Net Income Before Taxes:	\$2,500,000
• State and Federal Taxes:	<u>\$1,050,000</u>	• State and Federal Taxes:	<u>\$100,000<sup>2</sup></u>
• Net Earnings:	\$1,450,000	• Net Earnings:	\$2,400,000
• Dividend to Shareholders:	\$1,450,000	• Dividend to Shareholders:	\$2,400,000
• State Tax on Dividend:	\$87,000	• State Tax on Dividend:	\$0
• Federal Tax on Dividend:	<u>\$507,500</u>	• Federal Tax on Dividend:	<u>\$0<sup>3</sup></u>
• Net Dividend to Shareholder:	\$855,500	• Net Dividend to Shareholder:	\$2,400,000

**Total Annual Savings to Shareholders: \$1,544,500**

<sup>1</sup> Assumes that dividends payable by Company X do not qualify for the reduced federal rate of 15% because they either do not meet the requirements as Qualified Dividends under the U.S. Internal Revenue Code or are paid after December 31, 2012, which is the last date for which dividends qualify for the reduced rate.

<sup>2</sup> Assumes no gross receipt tax from Puerto Rico municipalities. Puerto Rico companies do not pay federal taxes on Puerto Rico source income.

<sup>3</sup> Puerto Rico residents pay no federal income taxes on Puerto Rico source income.



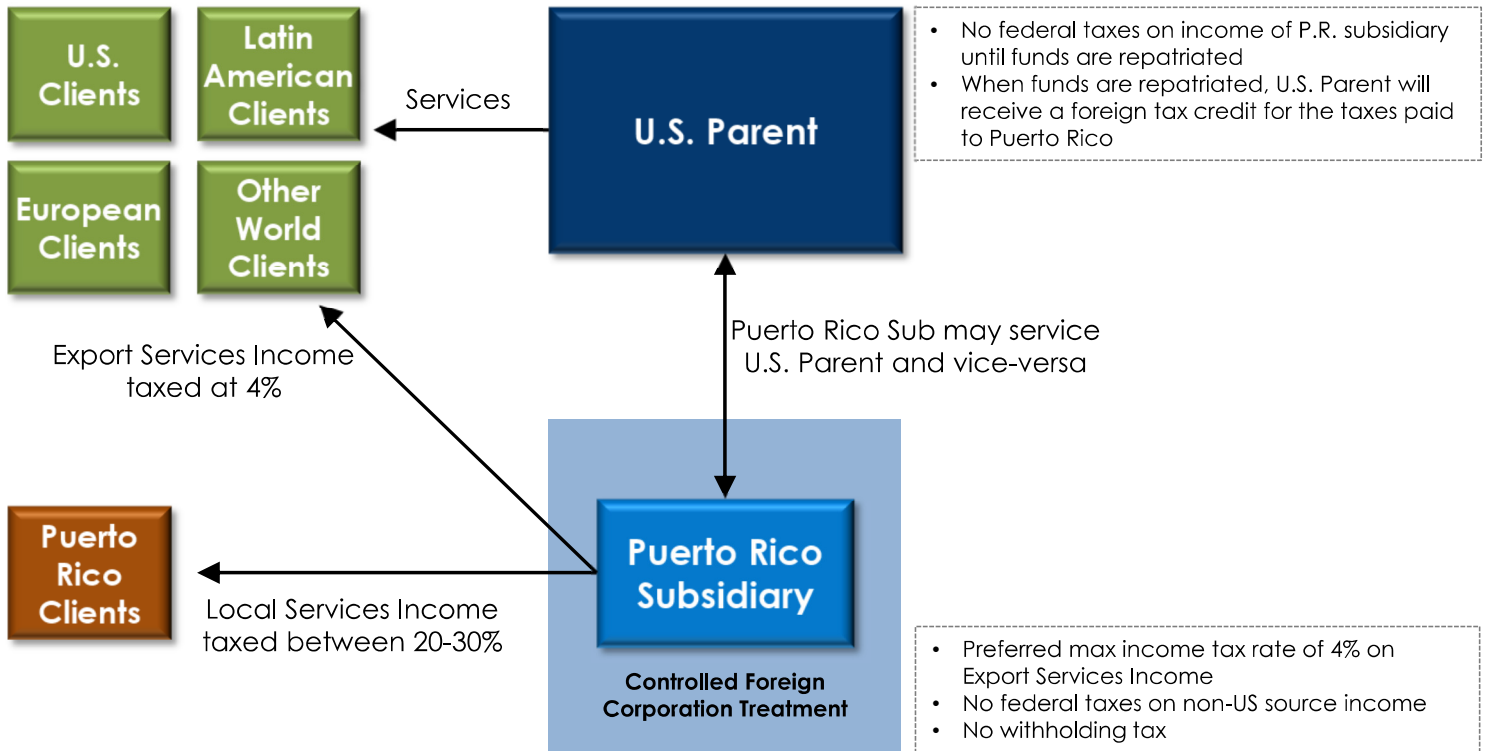
# Additional Considerations for Shareholders and Employees of New Puerto Rico Businesses

## Act to Promote the Relocation of Individual Investors (Act 22 of 2012)

- **Act 22 of 2012:** Those considering moving their businesses to Puerto Rico under the Act to Promote the Exportation of Services must also take into account the benefits of Act 22
  - **100% tax exemption on interest and dividend income** for New Residents of Puerto Rico
  - **100% tax exemption on all long-term capital gains** accrued after becoming a New Resident
- **Qualification Requirements:**
  - Act applies to any New Resident that had not been a resident of Puerto Rico at any time during the 15-year period preceding the effective date of Act 22, which period would be from January 16, 1997 through January 16, 2012
- **U.S. Federal Tax Considerations**
  - Puerto Rico Residents **pay no U.S. federal taxes** on Puerto Rico source income in accordance with Section 933 of the Internal Revenue Code of the United States
  - When investing through certain Puerto Rico investment vehicles, New Puerto Rico Residents may reduce the tax rate applicable on their interest and dividend income from sources outside Puerto Rico to 0% and 10%, respectively



## Subsidiary in Puerto Rico will be treated as a CFC for tax purposes



## Export services company may have shareholders in multiple jurisdictions

P.R. Residents are **100% exempt** from taxes on dividends



U.S. Residents must pay **15%\*** federal tax when dividends are distributed

**Export Services  
Company  
(Puerto Rico)**

- Preferred max income tax rate of 4% on Export Services Income
- No federal taxes on non-US source income
- No withholding tax

\* Qualified Dividend federal tax rate applicable until December 31, 2012, after which date dividends might be taxes as high as 39.6%



## Some of the Other Tax Incentives in Puerto Rico

### Puerto Rico has been aggressive in incentivizing strategic sectors

#### Manufacturing

- 4% income tax on industrial development income; 0% a 1% tax rate on income for pioneer or novel products manufactured in PR; 50% tax credit on purchases of products manufactured or recycled locally; \$5,000 for each job created during 1st yr of operation; 50% tax credit on Research and Development activities; \$5,000 tax credit per employment; special deductions on investments from structures, machinery and equipment

#### International Insurance

- The Insurance Code of Puerto Rico was amended to secure a tax regime that will apply to international insurers and would allow us to compete with Bermuda, Vermont and the Cayman Islands.

#### Tourism

- Tax credit of 10% of the total project cost or 50% of cash from investors, whichever is lower; 100% exemption on municipal construction excise tax; 100% exemption on taxes on imported goods and sales tax; 100% exemption on municipal licenses, 90% exemption on income tax; 90% exemption on property tax

#### Cruise Industry

- We expanded the cruise incentives package with a focus on job creation to reaffirm and strengthen the importance of Puerto Rico as a regional and world homeport, boost cruise traffic and room nights

#### Film Industry

- Production incentives: 40% tax credit on expenditures made in Puerto Rico; 20% tax credit on expenditures on non-resident talent. Infrastructure incentives: 25% tax credit on development or expansion costs, subject to a min investment of \$5 million. Tax incentives: Preferential income tax rate between 4% and 10%; 100% exemption on dividends; 90% exemption on property taxes; 100% exemption on patents, excise taxes and other municipal taxes

#### Renewable Energy

- We created measures to stimulate the development of sustainable energy systems by establishing the Green Energy Fund. We have special tax exemption for companies with the primary purpose of renewable energy generation, which include a fixed tax of 4% and a reduction on the property and municipal tax



## Contact Information

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You can also find more information about Puerto Rico and its incentives at:  
<http://puertoricodoesitbetter.com/>