



ACT 20 TAX INCENTIVES TO PROMOTE EXPORT SERVICES IN PUERTO RICO

On January 17, 2012 Puerto Rico enacted Act No. 20 of 2012, as amended, known as the “Act to Promote the Export of Services” (the “Act”), to offer the necessary elements for the creation of a World Class International Service Center. The Act provides tax exemptions and tax credits to businesses engaged in eligible activities in Puerto Rico. To avail from such benefits, a business needs to become an exempt business by applying for a tax concession and obtaining a tax exemption decree.

Eligibility

The Act provides benefits for services provided from Puerto Rico to outside markets. Eligible activities to receive benefits under the Act are services in the following areas:

- Research and development;
- Advertising and public relations;
- Consulting services, including, but not limited to, economic, scientific, environmental, technological, managerial, marketing, human resources, computer and auditing consulting services;
- Creative industries;
- Production of blueprints, architectural and engineering services, and project management;
- Professional services such as legal, tax and accounting services;
- Centralized management services, including, but not limited to, strategic direction, planning, distribution, logistics and budgetary services carried out by the headquarters or similar regional offices of an entity engaged in rendering such services;
- Centers for electronic data processing;
- Development of licensable computer software;
- Voice and data telecommunications between persons located outside of Puerto Rico;
- Call centers;
- Shared services centers, including, but not limited to, accounting, finance, tax, auditing, marketing, engineering, quality control, human resources, communications, electronic data processing, and other centralized management services;
- Storage and distribution centers;

- Educational and training services;
- Hospital and laboratory services;
- Investment banking and other financial services, including but not limited to, asset management, management of investment alternatives, management of activities related to private capital investment, management of hedge funds and high risk funds, management of pools of capital, management of trusts that serve to turn different types of assets into stocks, and management of escrow accounts;
- Commercial and mercantile distribution of products manufactured in Puerto Rico for jurisdictions outside Puerto Rico;
- Assembly, bottling and packaging operations of products for export;
- Marketing centers;
- Trading companies; and
- Any other service designated by the Secretary of the Department of Economic Development and Commerce of Puerto Rico.

No Nexus with Puerto Rico

The eligible activity must not have a nexus with Puerto Rico. In other words, the service must not be related to the conduct of a trade, business or other activity in Puerto Rico to qualify for the benefits of the Act. Promoter Services are excepted from this general rule, as further explained below under Promoter Services.

The following services will be considered to have a nexus with Puerto Rico, and will not be eligible services:

- Business or income producing activities that are or have been performed in Puerto Rico by the applying business;
- The sale of any property for the use, consumption or disposition in Puerto Rico;
- Counseling on the laws, regulations and administrative determinations of the Government of Puerto Rico and its instrumentalities;
- Lobbying on the laws, regulations and administrative determinations of the Government of Puerto Rico and its instrumentalities; and



- Any other activity designated by the Secretary of the Department of Economic Development and Commerce of Puerto Rico.

Promoter Services

Services considered non-eligible for having a nexus with Puerto Rico can be considered Promoter Services, thus becoming eligible services, when rendered to non-resident individuals and/or foreign entities, if they are related to the establishment of a new business (as defined in the Act) in Puerto Rico. Only net income derived from Promoter Services performed within the 12-month period ending on the day preceding the day the new business takes the earliest of the following actions will be considered exempt service income: (1) executes a contract to acquire or lease facilities in Puerto Rico; (2) begins construction of the facilities to be used in Puerto Rico; or (3) commences operations in Puerto Rico.

Tax Exemptions

At its core, the Act essentially extends to a broad spectrum of service industries the benefits that have made Puerto Rico one of the world’s manufacturing leaders. Manufacturing accounts for 44% of Puerto Rico’s GDP, compared with a U.S. average of less than 10%. Now, services enterprises ranging from advertising to accounting to legal services, as well as hedge fund managers and a wide range of other consulting firms are eligible for the benefits of the Act. Eligible activities can benefit from the following benefits on income derived from customers located outside of Puerto Rico in relation to services rendered from Puerto Rico:

- 4% fixed income tax rate;
- 3% fixed income tax rate in the case of services considered strategic;
- 100% tax exemption on distributions from earnings and profits;
- 90% tax exemption from personal property taxes for certain types of businesses (100% tax exemption for the first five years of operation). The taxable portion will be subject to the regular tax rate, that currently can be up to 8.83%; therefore, after considering the 90% exemption, the effective tax rate would be up to 0.883%;
- 90% tax exemption from real property taxes for certain types of businesses (100% tax exemption for the first five years of operation). The taxable portion will be subject to the regular tax rate, that currently can be up to 11.83%; therefore, after considering the 90% exemption, the effective tax rate would be up to 1.183%; and
- 60% tax exemption on municipal taxes (90% tax exemption if business operates in the industrial development zone constituted by the municipalities of Vieques and Culebra). Any taxable portion will be subject to the regular tax rate, that currently can be up to 1.5%; therefore, after considering the 60% exemption, the effective tax rate would be up to 0.6%;

Tax Exemption Decree

To benefit from the Act, the service provider needs to submit an online application through the DDEC Online Applications Platform to obtain a tax exemption decree, which will provide full detail of tax rates and conditions mandated by the Act and will be considered a contract between the Government of Puerto Rico and the service provider. Once the service provider obtains the tax exemption decree, the benefits granted will be secured during the term of the decree, irrespective of any changes in the applicable Puerto Rico tax laws. The decree shall have a term of 20 years, with a possible 10-year extension.

Puerto Rico Income Taxes

An exempt business operating in Puerto Rico under the Act by means of a Puerto Rico entity should not be subject to any taxes (such as a dividend tax, tollgate tax or other similar taxes) on its income from its eligible activities in Puerto Rico, other than the Puerto Rico fixed income tax rate established in the tax decree, regardless if said income is distributed or retained by the entity. Upon repatriation, the distributed income would be subject to the tax imposed by the jurisdiction in which the owners of the Puerto Rico entity reside, if any.

.....

For more information on the various incentives provided under the Puerto Rico laws, please visit WWW.BUSINESSINPUERTORICO.COM and access our incentives alerts on the following topics:

- Act to Promote the Export of Services
- Act to Promote the Relocation of Individual Investors to Puerto Rico
- Economic Incentives Act for Manufacture
- Incentives for Rum Producers in Puerto Rico
- Film Industry Economic Incentives Act
- Green Energy Incentives Act
- Tourism Development Act
- Cruise Ship Industry Promotion and Development Act
- Private Equity Funds Act

The content of this document has been prepared for information purposes only. It is not intended as, and does not constitute, legal advice on local or federal tax matters.

