



PrimeGlobal

*An Association of
Independent Accounting Firms*

DOING BUSINESS IN PUERTO RICO





COMPANY FORMATION IN PUERTO RICO

MAIN FORMS OF COMPANY/BUSINESS IN PUERTO RICO

The main forms of business in Puerto Rico are: Corporations, Limited Liability Companies, Joint Ventures, Partnerships, Sole Proprietorships, and Charitable Trusts.

Corporation – Foreign vs. Domestic

- A domestic corporation is a corporation formed under the laws of Puerto Rico.
- A foreign corporation is a corporation formed under the laws of any country other than Puerto Rico.

SPECIFIC TAX CONCERNS RELATED TO ESTABLISHING A COMPANY

REQUIREMENTS FOR DOING BUSINESS IN PUERTO RICO

Sale and Use Taxes

A Sale and Use Tax of eleven and a half percent (11.5%) (SUT) applies on sales of tangible personal property, taxable services, admission rights and combined transactions, subject to certain exclusions and exemptions. Designated professional services and business-to-business services (B2B) are subject to a SUT of four percent (4%).

A merchant is required to collect said tax as a withholding agent responsible for the payment of the Sales and Use Tax. He is also required to file a Monthly Sales and Use Tax Return, no later than the twentieth (20th) day of the following month in which the taxes were collected or in which the transaction subject to the tax took place.

Self-imposed SUT (reverse charge)

Applicable SUT will be Self-imposed by the business in Puerto Rico who receives the services from a non-resident or entity not engaged in trade or business in Puerto Rico, and is responsible for sending the SUT payment to the Treasury Department with the Monthly Sale and Use Tax Return applicable to Services on or before the 20TH of the next month following of making the payment or receiving the services. Otherwise, you cannot claim the deduction as an expenditure for those services in the Income Tax Return.

Importers of tangible personal property and Use Taxes

Every person who imports tangible personal property by any means, including postal service or air carrier, subject to the use tax, must file a USE TAX RETURN ON IMPORTS by the tenth (10th) day of the month following the month in which the transaction subject to the tax takes place. The filing must be made electronically through the PICO (Merchant Integrated Site) system. This requirement does not apply to the municipal sales and use tax.

It is important that every business which imports and files declarations as part of the process for taking possession of the merchandise, must be registered in PICO (Merchant Integrated Site) system. To register with PICO, you must visit PRTD web page www.hacienda.gobierno.pr and have an email address to create a personal user account.



DOING BUSINESS IN PUERTO RICO

LEGAL ISSUES RELATED TO ESTABLISHING A COMPANY

Before conducting business locally, all corporations or limited liability companies must register at the Puerto Rico State Department.

Puerto Rican corporations are treated as foreign corporations for U.S. income tax purposes. If a U.S. corporation decides to establish its operations in Puerto Rico through a Puerto Rican subsidiary, the latter will not constitute part of the consolidated group for purposes of U.S. income tax returns, since a P.R. corporation is considered a foreign corporation for U.S. purposes.

A foreign corporation (one that is organized under the laws of a country other than Puerto Rico) may engage in business in Puerto Rico as a division or branch of that foreign corporation or as a separate corporation or subsidiary. Resident foreign corporations are taxed in Puerto Rico on their Puerto Rican source income and on any effectively connected income at the same graduated tax rates as any domestic corporation.

A business operating in Puerto Rico may also be required to make the estimated income tax payments due on the fifteenth (15th) day of the fourth, sixth, ninth and twelfth month of the taxable year and penalties are imposed for underpayment of the estimated tax.

Corporations registered at the Department of State of Puerto Rico are required to file an annual corporation report on or before April 15th of every year.

All corporations (including branches) doing business in Puerto Rico are required to file an income tax return on or before the fifteenth (15th) day of the fourth month following the close of its taxable year. LLC must file on or before the fifteenth (15th) day of the third month following the close of its taxable year, if it is taxed as a pass-through entity.

Every group of corporations that are members of a group of related entities shall request a Group Identification Number to the Department of the Treasury. The number must be included, in the space provided, in each of the corporate income tax returns filed by the members of the group. The form may only be filed electronically through the online services of the Treasury Department website.

CULTURAL CONCERNS RELATED TO ESTABLISHING A COMPANY

Puerto Rico is a Caribbean island and unincorporated U.S. territory.

The official languages spoken are both Spanish and English.

Its national currency is the United States Dollar.

U.S. minimum wage laws apply.

OTHER COUNTRY-SPECIFIC ISSUES RELATED TO ESTABLISHING A COMPANY

In order to create, promote and develop a strong cluster of industries that export products and services, the Government of Puerto Rico has implemented a series of unparalleled tax and operational advantages and incentives. Prospect investors and entrepreneurs can benefit from this unique program, especially from those areas regarding tax exemptions.

Act 20 and 22 of this program stand out as pillars of the complete tax package. Exemptions included in Act 20,





DOING BUSINESS IN PUERTO RICO

Export Services Act, cover three main areas. Businesses that export services can 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.

In addition, eligible businesses will receive a 100% tax exemption on dividends derived from the export services income. They can also enjoy a 100% exemption on property taxes when they use local facilities as corporate headquarters, call centers or shared service centers. This exemption extends for a five-year period, and a 90% exemption will apply thereafter for the remaining period of time covered by the Tax Exemption Decree.

The program also encourages non-residents doing business in Puerto Rico for the past 15 years to become bona fide residents. Act 22, Individual Investors Act, provides a 100% tax exemption from Puerto Rico Income Taxes on all dividends and interest. This exemption also applies to both short and long term capital gains accrued after the individual becomes an official resident.





PERMANENT ESTABLISHMENT IN PUERTO RICO: BRANCH OR SUBSIDIARY?

DEFINITION OF A PERMANENT ESTABLISHMENT

A permanent establishment is an office or fixed place of business. The Tax Code of Puerto Rico does not stipulate an exact definition regarding a Permanent Establishment, rather a number of factors must be considered in order to determine whether or not a business is, in fact, considered a permanent establishment.

DEFINITION AND MAIN DIFFERENCES BETWEEN A BRANCH AND A SUBSIDIARY

A foreign corporation can operate in Puerto Rico either as a division/branch of the corporation; or, as a subsidiary/separate entity.

A branch operates identically to the parent corporation. A subsidiary is a separate entity, owned directly or indirectly by the parent corporation.

TAX AND ACCOUNTING OBLIGATIONS

Tax Incentive Laws in Puerto Rico

- 0% US Federal Income Tax

Export Services and Goods

- Act 20 of 2012

- 3-4% corporate tax rate
- 100% tax exemption on dividends or profit distributions from export services
- 100% exemption on property taxes for certain export services
- 20 year Government decree, renewable for an additional 10 years

Individual Investors

- Act 22 of 2012

- 100% tax exemption on dividends and interests
- 100% tax exemption on short and long-term capital gains
- Government decree valid until 2036
- Lowest individual passive income tax in the United States

I. Overview

On January 17, 2012, the Legislative Assembly of Puerto Rico approved new legislation to promote the economic development of Puerto Rico: (i) Act No. 22, also known as the Act to Promote the Relocation of Individual Investors to Puerto Rico (the "Individual Investors Act) and (ii) Act No. 20, also known as





DOING BUSINESS IN PUERTO RICO

the Act to Promote the Exportation of Services (the "Export Services Act").

The Individual Investors Act seeks to attract new residents to Puerto Rico by providing a total exemption from Puerto Rico income taxes on all passive income realized or accrued after such individuals become bona fide residents of Puerto Rico. This relocation should result in new local investments in real estate, services and other consumption products, and in capital injections to the Puerto Rico banking sector, all of which will accelerate the economy of Puerto Rico.

The purpose of the Export Services Act is to establish and develop in Puerto Rico an international export services center. This act seeks to encourage local service providers to expand their services to persons outside of Puerto Rico, promote the development of new businesses in Puerto Rico and stimulate the inbound transfer of foreign service providers to Puerto Rico. The act also creates a special fund for the continuous development of new tax incentives that will promote export services and the establishment of new businesses in Puerto Rico.

REGISTRATION FORMALITIES

Before conducting business, all corporations or limited liability companies must register at the Puerto Rico State Department.

Every entity engaged in business in Puerto Rico must obtain a federal Employer Identification Number (EIN) from the U.S. Internal Revenue Service (IRS) by filing Form SS-4. Upon obtaining an EIN, the entity must file a copy of the certificate of incorporation, and a copy of Form SS-4 at the P.R. Department of Treasury.

Every business (Merchant) in Puerto Rico must request a Merchants' Registration with the Puerto Rico Treasury Department (PRTD). Application must be presented thirty (30) days before initiating operations. Failure of timely registration may result in a \$10,000 fine.

When a new business is established, the semester in which it commences operations is generally exempt, provided that the business informs the Municipal Treasurer (within the first 30 days of operations) that it has established a business in the municipality. A tax return must be filed for the following semester annualizing the volume of business obtained during the first semester of operations. Semesters run from July 1 through December 31, and from January 1 through June 30.

STANDARD LEGAL OBLIGATIONS AND FORMALITIES FOR A BRANCH

Same as above (Registration Formalities), except new EIN is **not** required.





HOW TO HIRE MY FIRST EMPLOYEE IN PUERTO RICO

MAIN LEGAL STEPS TO FOLLOW TO HIRE A FIRST EMPLOYEE

An employer is required to withhold income tax at source on the salaries and wages paid to employees performing services in Puerto Rico. Employer is required to register its employer's identification number with the Puerto Rico Treasury Department within 30 days of initiating his employer's status. Failure to comply will result in penalties. In addition, the salaries and wages will not be deductible for tax purposes, and the employer will be liable for amount not withheld.

Employers must complete and retain Form 499-R-4 for each employee. The information provided is the support and authorization for income tax withholding on payroll payments.

Workmen's Compensation is a compulsory insurance that provides compensation for accidents incidental to or as a consequence of employment. The Puerto Rico State Insurance Fund Corporation provides this insurance. All employers are required to obtain it within 30 days of initiating operations.

Employers in Puerto Rico must register as an employer at the Department of Labor and Human Resources, and at the Bureau of Chauffeurs Social Security of Puerto Rico within 30 days of initiating operations.

An entity engaged in business in Puerto Rico must keep and maintain accounting records and supporting documents. Such documents will clearly show the financial condition and results of operations in Puerto Rico

A full set of audited financial statements (balance sheet, income statement and cash flow) must accompany all the statutory reports if the gross volume of business is three million dollars or more. On the other hand, the Annual Corporate Report will only be accompanied by an audited balance sheet, certified by a Puerto Rico licensed Certified Public Accountant (CPA).

DESIGN AND CONTENTS OF AN EMPLOYMENT CONTRACT

Unlike the majority of the United States, Puerto Rico is not an 'at will' employment state. Employment laws in Puerto Rico are structured in favor of employee's rights. Unless an employment contract is for a specified period of time, the employment is considered to be for an indefinite term. To terminate an employee, an employer must have 'just cause', or face a hefty fine. Just cause is specifically defined.

