

## Incentives Code - Changes to Act 20 & Act 22

August 27, 2019

### Summary

On July 1, 2019 (the “Effective Date”), the Governor of Puerto Rico signed into law the Puerto Rico Incentives Code as Act 60-2019 (the “Incentives Code”). In general, the Incentives Code compiles into a single code many of the Puerto Rico tax incentives laws used to promote the island’s economic development, with some modifications, in an effort to establish a new transparent and efficient process for granting and overseeing all the incentives afforded under the Puerto Rico’s incentives laws. We will discuss herein the major changes brought by the Incentives Code in relation to export services businesses (hereinafter referred to as collectively the “Export Services Business”), previously covered under Act 20-2012, as amended (“Act 20”), and resident individual investors (hereinafter referred to as the “Resident Individual Investors”), that were previously covered under Act 22-2012, as amended (“Act 22”).

### Detail

#### Resident Individual Investors (Former Act 22s)

The Incentives Code implements the following changes with regards to Resident Individual Investors:

- (i) The period during which an individual could not have been a resident of Puerto Rico to be eligible for tax benefits under Act 22 was changed. Under Act 22 such period is the six-year period preceding January 17, 2012 (the effective date of Act 22), whereas under the Incentives Code is now the ten-year period preceding the Effective Date.
- (ii) The annual charitable contribution to a non-for-profit entity was increased from \$5,000 to \$10,000. This requirement must be satisfied annually beginning with the second year following the issuance of the decree.
- (iii) There is now a new obligation to purchase residential property within the first two years after obtaining the tax decree. The grantee must hold exclusive and complete ownership of the residential property during the entire duration of the decree (joint ownership with spouse qualifies).

- (iv) A new definition to the word “securities” and a new term for “other assets” was added to narrow the benefits available with respect to the capital gains exemptions. Act 22 provides that the capital gains exemption was available with respect to “securities”, but such term was not defined in the law. In the absence of a statutory definition for the term “securities”, the Government of Puerto Rico incorporated the term “investment assets” in Act 22 decrees. However, and even though some Act 22 decrees were amended to provide that the term “investment assets” embraced essentially any capital asset, a clear definition of the term “investment assets” was never provided in regulations, administrative determinations or pronouncements of general applicability. The Incentives Code now clarifies that only capital gains derived from the sale of “securities” or “other assets” will be eligible for the tax benefits. The term “securities” is defined as any “note, bond, promissory note, evidence of indebtedness, options, futures, forwards, shares of stock and

## Puerto Rico Tax Alert

any other similar investment or with characteristics similar to the previously mentioned, including derivative instruments as provided in circular letter, administrative determination, regulation or any other pronouncement issued by the Secretary of Treasury and the Secretary of [Economic Development and Commerce]" and the term "other assets" is defined to include commodities, currencies, and any other digital asset or blockchain technology.

### Export Services Business (Former Act 20s)

The Incentives Code implements the following changes with regards to Export Services Business:

- (i) Individuals may also avail themselves of the tax benefits available to Export Services Business. There is no need to organize an entity (or authorize an entity to do business in PR) to be the holder of a tax grant.
- (ii) A new eligible export service is added for "Distribution in physical form, in the internet, by cloud computing or as part of a blockchain and the income derived from the licensing, subscription of the program or service charges".
- (iii) An employment requirement of one employee is implemented for Export Services Businesses that have an annual business volume greater than \$3,000,000 (the "Employment Requirement"). Specific instructions apply with regards to the timeline to comply with the Employment Requirement.
- (iv) Eligible services provided to a company engaged in business in Puerto Rico qualify for tax benefits under the Incentives Code, if the services are provided for the benefit of such company's customers located outside Puerto Rico. Thus, the fact that the direct recipient of the services is engaged in business in PR will generally not disqualify the service as an export service if the requirements of the Incentives Code are met (e.g., the benefit of the service is received outside of Puerto Rico and there is otherwise no nexus with Puerto Rico).
- (v) The list of eligible export service activities available under Act 20 has been divided into two separate categories: export services and export commerce. To be eligible under the export commerce category the person must have a *bona fide* office or establishment in Puerto Rico engaged in the business of trading or exporting products (trading companies) and at least 80% of its gross income must be derived from activities eligible as export commerce. The following activities are now classified as Export Commerce:
  - a. Activities previously covered under the trading company category of Act 20, but including the purchase and sale of any products (not just manufactured products);
  - b. Sales to non-PR persons of custom-made products, for use, consumption and disposition outside of Puerto Rico;

## Puerto Rico Tax Alert

- c. Sales and distribution to non-PR persons of intangible products, such as patents, copyrights, digital content and trademarks, among others;
  - d. Storage, transportation and distribution of products that belong to third parties (*hubs*);
  - e. Commercial and mercantile distribution of products manufactured in Puerto Rico for jurisdictions outside Puerto Rico; and
  - f. Assembly, bottling and packaging operations of products for export.
- (vi) The definition of eligible activities under the export services category confirms and clarifies that export services rendered outside of Puerto Rico are eligible for the tax benefits.
- (vii) The property tax exemption is reduced to 75% instead of the 90% exemption that was granted under Act 20 but is now available with respect to any eligible export service or export commerce activity. Under, Act 20 the property tax exemption was limited to certain services.
- (viii) The municipal license tax exemption is reduced to 50%, instead of the 60% exemption that was granted under Act 20. See Sections 2013.01 – 2013.03.
- (ix) An Exempt Services Business can enjoy under the Incentives Code a 75% exemption on construction excise taxes.
- (x) Grants issued under the Incentives Code have a duration of fifteen years, renewable for fifteen additional years.

Under Act 20, the grants are issued for twenty years, renewable for ten additional years.

- (xi) Export Services Businesses considered to be New PyMEs (as defined in the Incentives Code, i.e., average gross income of \$3 million or less) or located on the islands of Vieques and Culebra would have an income tax rate of 2% and 100% exemption on property and municipal taxes for the first 5 years.

Additionally, a new incentive is granted to individuals that qualify as new resident professionals that are not easy to recruit (the “Hard to Recruit Professionals”). The determination as to what is considered to be not easy to recruit is yet to be determined by regulation. A total Puerto Rico income tax exemption (including exemption from the alternate basic tax) is provided to such individuals on their salary and benefits in excess of \$100,000; provided that, he or she is domiciled in Puerto Rico, works on a full time basis with an entity that holds a grant of tax exemption under the Incentives Code and does not enjoy tax benefits as a Resident Individual Investor.

### Effectiveness

The Incentives Code became effective July 1, 2019, immediately after its execution. However, applications filed before December 31, 2019 can still be grandfathered under the provisions of Act 20 and Act 22. From January 1, 2020 and forward, all incentives application must be filed under the provisions of the Incentives Code.

## Puerto Rico Tax Alert

All rights and obligations acquired through a decree issued prior to the Effective Date shall continue to be honored by the Government of Puerto Rico. Existing grantees that will like to claim the benefits of the Incentives Code will

have to request a conversion or renegotiate their decree. Under the Bill of Rights for Decree Holders, in certain circumstances, new benefits provided through new laws or regulations can be extended under existing tax decrees.

### Contact us

If you would like to discuss this alert in more detail, please contact any of the attorneys below:

**Edgar Ríos-Méndez**

erios@pmalaw.com  
+1 (787) 274-4931

**Fernando Goyco-Covas**

fgoyco@pmalaw.com  
+1 (787) 274-5234

**Jose R. Cestero**

jrcester@pmalaw.com  
+1 (787) 274-4919

**Dianette Rivera-Meléndez**

drivera@pmalaw.com  
+1 (787) 773-6012

**Néstor R. Nadal**

nrmadal@pmalaw.com  
+1 (787) 274-4914

**Melvin J. Rivera**

mrivera@pmalaw.com  
+1 (787) 274-4922

**Vivianna Figueroa**

vfigueroa@pmalaw.com  
+1 (787) 274-5249