

Setting up your Business in Puerto Rico

Issues to consider



Puerto Rico, a Caribbean island, is one of the world's most vibrant destinations to establish, relocate and expand a business. Puerto Rico offers the security and stability of operating in a U.S. jurisdiction with an array of special tax incentives for foreign direct investment that can be found nowhere else in the world. Our skilled and highly educated workforce, our world-class infrastructure, innovation centers and low cost of doing business, attracts diverse kinds of industries to invest in the island.

However, there are a number of issues which you must consider when you are looking to set up your business in Puerto Rico. This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

What type of Business Structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

Foreign Corporation (a branch or subsidiary of the overseas business)

- A foreign corporation may not conduct business in Puerto Rico prior to receiving authorization from the Secretary of State.
- The branch is not a separate legal entity but an extension of the overseas parent company and the Subsidiary is a separate legal entity
- Provides limited liability or ring-fencing of the Puerto Rico operations
- File a Corporation tax return and pay tax on company profits from Puerto Rico operations
- Branch is subject to a deemed distribution 10% branch profit tax on advances to parent company
- Subsidiary actual repatriation of dividends will be subject to a 10% withholding at source
- Accounts require auditing if Annual Revenues from Puerto Rico operations are over \$ 3 million.

Domestic Corporation:

- Organized under the laws of Puerto Rico
- Provides limited liability and ring-fencing to Puerto Rico operations
- Gives a perception of a local business, with longevity
- File a Corporation tax return and pay tax on company's worldwide profits
- Accounts require auditing if Annual Revenues are over \$ 3 million.

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Partnership:

- Partnerships are flow-through entities and profits are allocated to members who then pay Income Tax on these profits personally.
- Accounts require auditing if Annual Revenues are over \$ 3 million

Limited Liability Partnership:

- Members (partners) have limited liability
- Profits are allocated to members who then pay Income Tax on these profits personally
- Accounts require auditing if Annual Revenues are over \$ 3 million

Limited Liability Company

- Any natural or judicial person may organize a limited liability company in Puerto Rico, and the articles of organization are required to be filed with the Puerto Rico Department of State
- Provides limited liability and ring-fencing to Puerto Rico operations
- For income tax purposes, limited liability companies will be taxed in the same manner as corporations, but may elect taxation as a partnership
- Accounts require auditing if Annual Revenues are over \$ 3 million

How much Corporation Tax will the business pay?

Corporate regular income tax is made up of a normal income tax and surtax. The normal tax is computed on the net taxable income of the corporation. The normal tax rate is 20%. The surtax is computed on the surtax net income (net taxable income less the surtax deduction of \$25,000). Surtax tax rates range from 5% to 19%.

<u>Income subject to Surtax</u>	<u>The Surtax will be</u>
Not over \$75,000	5%
\$75,001 - \$125,000	\$3,750 + 15% of the excess over \$75,000
\$125,001 - \$175,000	\$11,250 + 16% of the excess over \$125,000
\$175,001 - \$225,000	\$19,250 + 17% of the excess over \$175,000
\$225,001 - \$275,000	\$27,750 + 18% of the excess over \$225,000
Over \$275,001	\$36,750 + 19% of the excess over \$275,000



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Issues to consider



Puerto Rico also offers to eligible businesses highly attractive tax incentive packages that includes a fixed corporate income tax rate (4% to 8%) – one of the lowest in comparison with any U.S. jurisdiction – various tax exemptions and special deductions, training expenses reimbursement and special tax treatment for pioneer activities.

What if we use Puerto Rico to set up our holding company?

Puerto Rico is a very attractive place to set up corporate headquarters if over 90% of the entity's gross income is derived from services for export and these services are considered strategic services.

The tax incentive for these businesses is a 4% fixed tax rate on the net export services income, 100% exemption on dividend distributions and 90% exemption on property tax and municipal tax.

What if we make cross-border transactions between group companies?

Puerto Rico follows internationally recognized **Transfer Pricing** (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis. The price and terms should be the same as if the transactions had been between completely independent parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods
- Provision of management services
- Property rental charges
- Transfer of intangible assets e.g. trademarks, patents
- Sharing of knowledge, expertise, business contacts etc.
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans

The PR Treasury Department may audit the entity and it has to prove the arm's length basis and ensure transactions are undertaken at a commercial value.

What Employment Taxes and Social Security will need to be paid?

Puerto Rico individual residents are subject to Puerto Rico tax laws. If the individual has been present in Puerto Rico for at least 183 days during the year is presumed to be a resident. The individual is subject to Puerto Rico income tax on Puerto Rico source income.

We would advise any new entrant to Puerto Rico or person who spends time working in Puerto Rico to take professional advice to determine whether he is a Puerto Rico tax resident.

Setting up your Business in Puerto Rico

Issues to consider



Current Personal Income Tax rates in Puerto Rico are:

<u>Net taxable Income</u>	<u>The tax will be</u>
Not over \$9,000	0%
\$9,001 - \$25,000	7% of the excess over \$9,000
\$25,001 - \$41,500	\$1,120 + 14% of the excess over \$25,000
\$45,501 - \$61,500	\$3,430 + 25% of the excess over \$41,500
Over \$61,500	\$8,430 + 33% of the excess over \$61,500

Social Security Tax

Employers and employees also have to pay social security tax in Puerto Rico. The provisions of the United States’ Old Age, Survivors and Disability Insurance Act (“OASDI”) and the Hospitalization Insurance Tax (Medicare), commonly known as FICA or social security, are applicable in Puerto Rico. The tax rate for Social Security is 6.20% and for Medicare is 1.45%. The 7.65% (6.20 + 1.45) must be deducted from the employee and the employer has to match also 7.65%.

What is Sales and Use Tax (SUT) and should the business be registered?

Since November 16, 2006 Puerto Rico has implemented a Sales and Use Tax. It is imposed at a rate of 10.5% at the state level and 1% at the municipality level. The sales and use tax generally applies to all retail sales including mail orders, sale of tangible personal property or services, admissions fees, storage, use or consumption in Puerto Rico. Limited exceptions include non-processed foods, prescription medicines, most rental of real property, and the following services: medical-hospital, professional, educational, financial, governmental, inter-business and insurance, among others.

Vendors must register and collect sales tax. The sale and use tax introduced by the Act replaced the general 6.6% excise tax applicable to most articles imported to Puerto Rico.

Beginning on October 1, 2015 a 4% Special SUT Rate was implemented to the Services rendered Business to Business and the Designated Professional Services that are the legal services and the services provided by duly licensed professionals; Agronomists, Architects and landscape architects, Certified Public Accountants, Real estate firms, agents and brokers, Professional Drafters, Real estate appraisers, Geologists, Engineers, and Surveyors.

The 4% Special SUT also apply to the services rendered by a non-resident person to a person located in Puerto Rico, regardless of where the service has been rendered, provided such service is directly or indirectly related with the operations in Puerto Rico.



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Can we provide Share option plans to our staff?

Many companies see Stock Option plans as being an important way of attracting, motivating and retaining key staff. Puerto Rico has a number of “approved” share option plans which give tax benefits to employees and employers.

However, this is a very technically complex area and careful planning needs to be undertaken as soon as stock option plans are being considered for implementation in Puerto Rico.

How else can we compensate our employees?

Puerto Rico has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, employee’s benefits plans including retirement plans, private medical insurance, and life and disability insurance covers are commonplace benefits provided by many Puerto Rico businesses to their workforce.

To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or [email](#) us directly.

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