

# DOING BUSINESS

November 2015

## PUERTO RICO



SMS Latinoamérica



## **DOING BUSINESS IN PUERTO RICO**

### **Geography and Population**

Puerto Rico is the most eastern of the Greater Antilles between the Caribbean and North Atlantic Ocean, about 1,050 miles southeast of Miami. By air, it is just over 3 hours from New York.

According to the 2010 US Census, Puerto Rico has a population of approximately 3.726 million people

### **Political and legal system**

A self-governing Commonwealth within the United States constitutional system, island government consists of the Executive, Legislative and Judicial branches. General elections are held every four years. There are 78 municipalities on the island, each with a locally elected mayor and assembly. Puerto Rico came under United States sovereignty pursuant on December 1988 and Puerto Ricans have been citizens of the United States since 1917.

Although Puerto Ricans are US citizens, residents pay no federal income tax on their Puerto Rico source income, nor can they vote in presidential elections. As citizens, Puerto Ricans do not require a visa to travel, live and/or work in the USA.

### **Language**

The primary language is Spanish. English is spoken by about a quarter of the population and in all major tourist areas.

### **Economic overview**

Puerto Rico's economy is strong compared to many other Caribbean nations and diversification of the economy of Puerto Rico, coupled with investments and funding from the United States, has created an economic environment that does not rely solely on tourism for financial prosperity. A diverse industrial sector has surpassed agriculture as the primary source of economic activity and income. Encouraged by duty-free access to the US and by tax incentives, US firms have invested heavily in Puerto Rico since the 1950s.

Both coffee and tobacco are an important agricultural products produced in Puerto Rico. Additional resources produced in limited quantities in Puerto Rico are dairy products, vegetables, fruits, beef and poultry. Tourism has traditionally been an important source of income.

### **Business entities**

Once a group of investors or an entity decides to come to Puerto Rico to do business, its management must decide which type of entity will better serve their purposes. Puerto Rico Corporate and Tax Laws allow several options. The following constitutes a brief summary of these:



## **Corporations**

### **Foreign**

#### ***Qualifying to do business in Puerto Rico***

A foreign corporation may not conduct business in Puerto Rico prior to receiving authorization from the Secretary of State. In order to obtain such authorization, certified copies of the corporation's charter and certificate of incorporation and of the Certificate Required to do Business in Puerto Rico must be filed with the Department of State. The fees required by the State Department to process and issue the certificate of registration are \$150. Legal process against the corporation may be served on its authorized resident agent, who must be either a natural or judicial person residing in Puerto Rico, but cannot be a stockholder, officer or director of the corporation.

A foreign corporation (one that is organized under the laws of any country but Puerto Rico) may be engaged in trade or 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 Rico source income and on any effectively connected income at the graduated tax rates as any domestic corporation.

#### ***Subsidiary***

Any actual repatriation of dividends will be subject to a 10% income tax withholding at source. If a US subsidiary is used, it may be included in the US consolidated tax return with its parent.

#### ***Branch***

Income taxation of a US branch is the same as for a US subsidiary. The only difference will be that a deemed dividend distribution tax (branch profit tax or BPT) will be assessed on the branch upon any advances made to its home office. The BPT rate is 10%.

### **Domestic**

A domestic corporation (one organized under the laws of Puerto Rico) is taxed on all its worldwide income. If tax is paid to a foreign jurisdiction, then a foreign tax credit or deduction may be claimed, subject to certain limitations. If a US corporation decides to establish its operations in Puerto Rico through a domestic subsidiary, the latter will not constitute part of the consolidated group for purposes of the filing of US income tax return, since a PR corporation is considered a foreign corporation for US purposes. Dividends are generally subject to a 10% income tax withholding.

#### ***Partnerships***

Under the provisions of the Internal Revenue Code for a New Puerto Rico (approved in January 31, 2011) partnerships are flow through entities. Rules similar to those applying to partnerships in the US were adopted.

#### ***Special partnerships (Referred to in Spanish as a Sociedad Especial)***

A partnership or a corporation that meets certain requirements may have elected to be treated as a special partnership for income tax purposes. This treatment allows for a pass through of income and losses to the owners of the entity, eliminating the double taxation applicable to regular corporations and partnerships. In order to qualify, at least 70% of the gross income of the entity must be from Puerto Rico sources and 70% must be from the

performance of one or more of the qualifying activities (i.e. land development, tourism, building and structures lease, sale or rehabilitation, construction, agriculture, film production). The special partnerships election is not available for years commencing after December 31, 2010. Those elections for prior years are still effective.

### ***Corporation of individuals (Referred to as N Corporation)***

Domestic corporations and partnerships which are owned by 75 or less individuals may elect to be treated as a corporation of individuals for tax purposes if certain requirements are met: at least 90% of the gross income is derived from an active trade or business in Puerto Rico (certain activities do not qualify). The term domestic corporation or partnership includes for these purposes, a US entity which is solely engaged in a trade or business in Puerto Rico. Like special partnerships, a corporation of individuals allows the flow through of income and losses to the owners, eliminating the double taxation of income.

### ***Limited Liability Companies***

Any natural or judicial person may organize a limited liability company in Puerto Rico. The articles of organization are required to be filed with the Department of State, where it becomes available for public inspection. Every limited liability company is required to maintain in the Commonwealth of Puerto Rico a registered office and a resident agent, whom shall be an individual resident in the Commonwealth of Puerto Rico, a domestic corporation (which may be the LLC itself), or a foreign corporation authorized to do business in Puerto Rico. The fee required by the State Department is \$250 for a certificate of authorization.

For income tax purposes, limited liability companies will be taxed in the same manner as corporations. Nevertheless, LLCs may elect to be treated as partnership by filing Form 6045 Partnership or LLC Classification Notification or Election on or before the last day of the third month of the taxable year for which such notification or election will be effective. However, if the LLC is treated as a flow through or disregarded entity for US or other foreign country income tax purposes, it must be treated as such for Puerto Rico income tax purposes.

### ***Corporations operating under a Tax Incentives Act***

There are several Acts that provide tax and business incentives to qualifying business operations that decide to establish in Puerto Rico.

Act No. 73 Known as the economic Incentive Act for the Development of Puerto Rico, was established to provide adequate environment and opportunities. The tax benefit are as follows:

- ⇒ 4% income tax on industrial development income
- ⇒ 0% tax on dividends or profit distributions
- ⇒ 0% to 1% tax rate on income for pioneer or novel product manufactured in PR
- ⇒ Up to 50% Tax credit on Purchase of product manufactured or recycled locally
- ⇒ Up to 50% Tax credit on Research and Development activities



Act No. 273 Known as The international Financial Center Regulatory Act, was enacted with the objective of making Puerto Rico an international banking and financial center by providing tax incentives for new banking and financial activity in Puerto Rico that is done for clients outside of the island.

Act No. 20 Known as the Act to Promote the Exportation of Services, provides attractive tax incentive for companies that establish and expand their export services business in the island.

The tax benefits are as follows:

- ⇒ 4% income tax on industrial development income
- ⇒ 0% tax on dividends or profit distributions
- ⇒ 90% tax exemption on property taxes for certain property used in export services business.
- ⇒ 60 tax exemption on municipal taxes
- ⇒ Decree of 20 years, renewable for an additional 10 years.

Act No. 22 Known as 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 bonafide residents of Puerto Rico.

- ⇒ 0% tax on dividends and interest for new Puerto Rico residents.
- ⇒ 0% Tax on short and Long term capital gains
- ⇒ Decree of 20 years, renewable for an additional 10 years.

### **Statutory reporting requirements**

Entities registered or engaged in a trade or business in Puerto Rico, are required to prepare and file various statutory reports with the different governmental agencies. There are four basic returns that apply to almost every entity. These are:

#### **Income tax return**

Entities engaged in a trade or businesses in Puerto Rico are subject to income taxes (ranging from 20% to 39%).

A return must be filed with the Secretary of the Treasury by corporations on or before the 15th day of the fourth month following the end of the taxable year. In the case of entities treated as flow through, the return is due by the 15th day of the third month following the end of the taxable year. A three (3) month-extension to file such return is available.

A foreign entity (one not organized in Puerto Rico) is subject to Puerto Rico income taxes on its Puerto Rico sourced income and on its income effectively connected with the Puerto Rico operations. They are allowed to deduct expenses related to the Puerto Rico operations, such as depreciation, professional services, travel, supplies, etc. An allocation of home office expenses is also allowed.



### **Estimated income tax payments**

Payment of the tax must be done in four installments on or before the 15th day of the fourth, sixth, ninth, and twelfth month of the taxable year.

### **Volume of business declaration**

All businesses are required to pay a license tax based on gross revenues generated. The tax rate varies depending on the municipality but ranges from .002 to .005 in the case of non-financial businesses. For financial business the tax rate ranges from 1% to 1.50%. The return and the tax (if a 5% discount is taken) are due on or before five working days after April 15 of every year. Up to six months of extension are available but only to file the return. If the business decides not to take advantage of the 5% discount, then the full amount of the tax is payable in two installments: July 1 and January 1.

### **Personal property tax return**

All personal property is subject to a tax that ranges from 5.80% to 8.83% depending on the municipality in which it is located at assessment date: January 1. The return and payment is due on or before May 15 of every year and must be filed with the Municipal Revenue Collection Center (CRIM). A 90-day extension to file is available for corporation. In the case that the taxpayer is not a corporation, a 30-day extension to file is available, as well as a 60-day additional extension of time to file. There is also the imposition of a real property tax for which no return needs to be filed. The CRIM issues the biannual receipts once the property is assessed. Tax rates range from 7.80% to 10.83%.

### **Annual reports**

In the case of corporations registered with the Department of State of Puerto Rico, an annual corporation report must be filed on or before April 15 of every year. A several extensions to file are available. The report must be filed by electronic means and a filing fee \$150 must be paid on or before April 15.

### **Exempt corporations' annual report**

Every business operating under a Tax Incentives Act must also file this report on or before 30 days after filing the Puerto Rico Income Tax Return with the Office of Industrial Tax Exemption at the Puerto Rico Industrial Development Company (PRIDCO). A filing fee of \$300 must accompany the report. In addition, a copy of the same must be filed with the Department of the Treasury, Sales and Use Tax including copy of the filing fee.

### **Merchants' Registry**

Any person or legal entity that sells goods, manufactures goods or provides services in Puerto Rico and/or has business operations in the Commonwealth of Puerto Rico has to register in the Merchants' Registry of the Puerto Rico Department of Treasury. This registry is obligatory, irrespective of the sales volume.



### **Sales and Use Tax**

Every merchant must file a Monthly Sales and Use Tax Return on or before the 20th day of the following month in which the tax is collected. Merchants regardless of its monthly volume of business must file the return along with the sales and use tax collected by electronic means. There is no extension available to file the monthly sales and use tax return.

### **Audited financial statements**

Existing laws in Puerto Rico require that in the case of certain corporations and partnerships, the above listed reports must be accompanied by audited financial statements certified by a Puerto Rico licensed Certified Public Accountant (CPA).

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, except for the Annual Corporate Report, which must be accompanied by only an audited balance sheet.

### **Books and records**

A foreign corporation engaged in trade or business in Puerto Rico must keep and maintain accounting records and supporting documents in Puerto Rico, which will clearly show the financial condition and results of operations within Puerto Rico.

### **Procedures to be followed by a new business**

In addition to all the legal and organizational work a newly organized or registered business in Puerto Rico must comply with, it should also obtain several identification numbers and forms to be used with the different governmental agencies.

### **Employer identification number**

Form SS-4 with the US Internal Revenue Service. Taxpayers may also obtain the number by phone. The person making the call should be an authorized individual to sign Form SS-4. Fax Number 215-516-3990, Telephone Number 215-516-6999. If the business already has a number assigned, that will be the ID number to be used in Puerto Rico too.

### **Puerto Rican income tax withholding**

Form SC-4809 must be filed with the Puerto Rico Department of Treasury as soon as you obtain your federal social security number. This form should be accompanied with a copy of the certificate of incorporation and a copy of Form SS-4.



### **Withholding exemption certificate**

Form 499-R-4 from each employee. The information provided therein will be the support and authorization for income tax withholding on payroll payments.

### **Workmen's compensation insurance**

Form FSE-661 from the Corporation of the State Insurance Fund.

### **Unemployment and Disability Insurance**

Form PRUI-1 from the Department of Labor and Human Resources.

### **Chauffeur insurance plan**

Form TSCH-7 and TSCH-7A, which must be filed within seven days of hiring a covered employee.

### **Sales and Use Tax**

Form AS 2914 must be filed with the PR Treasury Department 30 days before the business starts operations. In case of those merchants who are eligible to request the certificate of exemption, the same should also be requested using Form AS 2914.

### **Merchants' and Businesses' Mandatory Registry**

Any person or business that renders a service, sells or manufactures a product in the Commonwealth of Puerto Rico and operates on for-profit basis is required to register with the Merchants' and Businesses' Mandatory Registry. The registration may be filed in paper or electronically, accessing the internet portal: [www.hacienda.gobierno.pr](http://www.hacienda.gobierno.pr).

## **Payroll and social security taxes**

### ***Payroll taxes***

Employers in Puerto Rico are responsible for the following payroll taxes: income tax withholding, social security (FICA), state and federal unemployment, disability tax, chauffeurs' social security, and workmen's compensation.

### ***Disability benefits act***

This Act provides benefit payments to employed workers who suffer the loss of wages as a result of inability to perform their customary work due to injury, illness or pregnancy. The tax rate is .003 on the first \$9,000 of wages to both the employer and the employees.

### ***Unemployment insurance tax***

Every employer having one or more employees is liable for both the state and federal unemployment tax.





### **State (SUTA)**

The tax is computed on the first \$7,000 of wages paid based on an experience system. In addition, a special tax of 1% of taxable wages must be paid. The total tax may not exceed 5.4%. This tax is totally the liability of the employer.

The Puerto Rico Department of Labor requires every employer hiring 25 employees or more to file the quarterly payroll tax forms electronically. You can access the Department of Labor portal which provides electronic services, claimants and public in general. Visit [www.dtrh.gobierno.pr](http://www.dtrh.gobierno.pr).

### **Federal (FUTA)**

The tax for 2015 is based on the first \$7,000 of wages paid to each employee. Because employers are allowed credits against the 6.0% FUTA rate, effective on July 1, 2011, through participation in state unemployment insurance laws, the net FUTA rate actually paid by most employers is 0.6%.

The tax must be deposited on or before the last day of the month following each calendar quarter, if the tax exceeds \$500. Payment should be made electronically by using the Electronic Federal Tax Payment System (EFTPS) or by depositing your tax with an authorized financial institution.

An annual return (Form 940-PR) must be filed on or before January 31. Any payment due and the return should be sent to the Internal Revenue Service, PO Box 105174 Atlanta, GA 30348-5174. If no payment is due, the annual return should be filed with the Internal Revenue Service, PO Box 409101 Ogden, UT 84409.

### **Chauffeurs' social security**

Every employer having one or more drivers is subject to the tax. It also applies to an employer whose employees are required or allowed to operate a motor vehicle usually or regularly as an inherent part of their work.

The tax is imposed on both the employer and the employee as follows:

- Every employer must pay thirty cents (\$0.30) weekly, or fraction for each covered employee
- Every employee must pay fifty cents (\$0.50) per week or fraction.

The tax withheld together with the employer's share should be paid not later than fifteen days after the last day of each calendar quarter. The check, made to the Secretary of the Treasury, and the return must be sent to the Department of Labor, Bureau of Chauffeurs Social Security, 505 Muñoz Rivera Avenue, San Juan, Puerto Rico 00918 or by mail to PO Box 195540, San Juan, P.R. 00919-5540.

The Puerto Rico Department of Labor requires every employer hiring 25 employees or more to file the quarterly payroll tax forms electronically.

### **Income tax withholding on wages**

Every employer making payment of wages shall deduct and withhold the corresponding tax according to the withholding tables. There is no wage limitation for the withholding.

The Puerto Rico Treasury Department issued rules for the deposit of the income tax withheld which are very similar to the rules applied by the IRS for the deposits of payroll taxes.



A quarterly return must also be filed, no later than the last day of the month following each calendar quarter, with the Returns Processing Bureau, Employer's Section, PO Box 9022501, San Juan, P.R. 00902-2501.

An annual reconciliation statement (Form 499R-3) along with copy A of Form 499R-2/W-2 PR must be filed not later than January 31 at the same address. A 30-day extension to file is available. The above-mentioned forms will be sent to you once you apply for your employer account number. The Puerto Rico Department of Treasury requires that every person obliged to file 5 or more Forms 499R-2/W-2PR must do so electronically.

### **Workmen's accident compensation insurance**

The Workmen's Accident Compensation Act establishes a compulsory insurance program covering employees who suffer injury, become disabled or lose their lives due to a job related accident or function.

The rates per occupation or industrial classifications are summarized in a booklet prepared by the Corporation of the State Insurance Fund called "Manual of Classifications and Rates for Workmen's Compensation Insurance".

Every employer must file by July 20 of each year, a payroll statement (Form FSE 693) showing the number of employees, occupation or industry classification and the respective total amount of wages paid during the immediately preceding fiscal year ended June 30. At the end of each fiscal year the Manager of the Fund compares the payroll reported with that of the preceding fiscal year, upon which the current year's premium is based. He then adjusts the premium accordingly.

Although the insurance premium is assessed and levied on a fiscal year ended June 30, the tax is paid semi-annually on January 20 and July 20 upon notice mailed to the employer by the Manager of the Fund. The payments can be made electronically at [www.cfse.gov.pr](http://www.cfse.gov.pr) or by sending a check payable to the Corporation of the State Insurance Fund and mailed to Corporation of the State Insurance Fund, Call Box 42006, Minillas Station, San Juan PR 00940.

### **Social security taxes**

For 2015 the employer and the employee, each, are subject to a combined tax rate of 7.65%, which consists of 6.2% Social Security Tax and 1.45% Medicare Tax. For subsequent years, as applicable by law in effect. For 2015 the Social Security Tax is computed on the first \$118,500 wages received. This ceiling is subject to change each year. The Medicare tax is computed on the total wages, without ceiling.

Effective January 1, 2013 employers will be required to withhold an additional Medicare tax of 0.9% on high-income tax payers (the Medicare surtax) on wages and other compensations in excess of \$200,000.

If an employee works for more than one employer during a calendar year, the annual wage applies separately with respect to the wages paid by each employer.

The quarterly return (Form 941-PR) of combined employer's and employee's social security taxes (FICA) is due on April 30, July 31, October 31 and January 31. The return along with the payment should be filed with the Internal Revenue Service, PO Box 105273, Atlanta, GA 30348-5273. If no payment is due, the return should be filed with the Internal Revenue Service, PO Box 409101, Ogden, UT 84409.

There is an annual return (Form 944-PR) which is due on January 31 and applies only to certain small business or new employers. The IRS will send a notification to the employers eligible to file this return.

The employer must give the employee two copies of Form 499R-2/W-2 PR on or before January 31, following the end of the calendar year in which the tax was withheld.



### **Social security taxes deposit rules**

Employers must determine how frequently they should deposit the social security taxes every year. Which category an employer is in for a calendar year will be dictated by the amount of employment taxes reported for a one year look back period ending the preceding June 30th. For calendar year 2015, the look back period is the period from July 1, 2013 to June 30, 2014. The different categories for deposit are the following:

- monthly depositors: \$50,000 or less.
- semi-weekly: more than \$50,000.
- one-day depositor: taxes of \$100,000 or more during a deposit period.
- quarterly deposit: \$2,500 or less on any quarter.

### **Withholding taxes**

#### ***Withholding tax on payments for services rendered***

The Government of Puerto Rico and every person that in the conduct of a trade or business or for the production of income in Puerto Rico makes payments to another person engaged in trade or business in Puerto Rico for services rendered in Puerto Rico must deduct and withhold 7%. The service provider may elect to have withheld 10% or 15%, instead.

Corporations and partnerships may get a reduced withholding tax of 3% if they are in good standing with the Puerto Rico Treasury Department (waiver). A “Partial Relief of Withholding Certificate” must be obtained and remitted to each payer to benefit from the reduced tax withholding. Also, the Secretary of the Treasury may issue a total waiver to corporations and regular partnerships that are in the first three years of operations, reflect net operating losses on their income tax return or are required to provide audited financial statements to their returns. In addition, special partnerships and corporations of individuals that are required to provide audited financial statements may also obtain a total waiver.

The tax must be deposited, along with Form 480.9A, on or before the 10th day of the month following the month in which the tax was deducted and withheld. In addition, an informative return must be filed by February 28 of the following year covering such payments and withholdings during the calendar year (Form 480.6B). Form 480.5 should also be filed summarizing the number of informative returns filed.

An Annual Reconciliation Statement of Withholding at Source on Payments for Services Rendered (Form 480.6B.1) must be filed by the same date.

The Puerto Rico Department of Treasury requires that every person that is obliged to file five (5) or more informative returns must do so electronically.

#### ***Withholding tax on interest, dividends, and other payments***

Payments of fixed or determinable annual or periodic gains, profits and income from Puerto Rico sources to non-resident corporations or partnerships and to non-resident individuals are subject to income tax withholding at source. In general, payments to non-resident corporations and partnerships and aliens are



subject to a 29% income tax withholding at source while payments to non-resident US citizens are subject to a 20% income tax withholding at source.

## **Indirect taxes**

### ***Excise taxes and other licenses***

Puerto Rico imposes an excise tax on cigarettes, vehicles, alcoholic beverages, gasoline, oil and end products derived from oil, cement and certain plastic products imported to Puerto Rico. There is a different tax rate for each of the products mentioned above. In addition, there are several exceptions to this general rule and some exemptions to the imposition of the tax.

Depending on the type of business you are proposing to start in Puerto Rico, you must be aware that you might be required to obtain certain licenses from the Puerto Rico Treasury Department or other agencies (i.e. alcoholic beverage, cigarettes, financial institutions and air, land and sea carriers, among others).

### ***Sales and Use tax***

Every merchant engaged in any business that sells taxable items is responsible to collect the Sales and Use Tax ("SUT") as a withholding agent. The SUT rate is 10.5% and in general will apply to the following items:

1. tangible personal property,
2. taxable services,
3. admission rights
4. bundled transactions.

There will be a special 4% service tax over designated (licensed) professional services and to business to business services previously exempted in the law up to March 31, 2016. There after the tax will increased from 4% to 10.5%. The municipal sales and use tax of 1% will not be applicable to this type of services.

The law also provides several exclusions and exemptions from the SUT, which depend on the taxable item purchased or the person who purchases the item, such as state general government, municipalities, governmental agencies and instrumentalities, educational services and medical services.

# Cuenta con Nosotros

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