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Tax Update

Tax Incentives for Export Services and Export Commerce under the Incentives Code

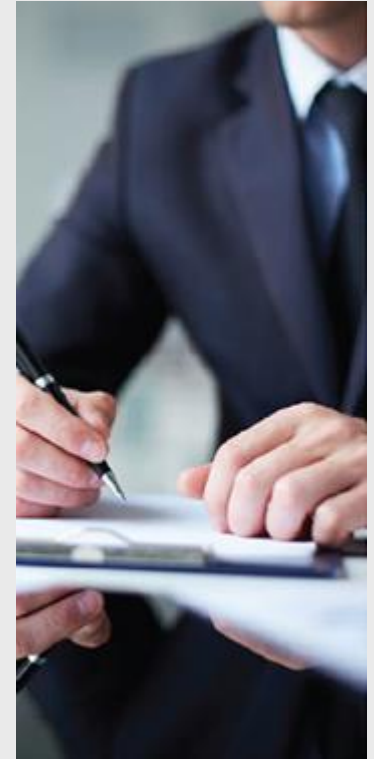
Through the enactment of Act 60-2019, the tax incentives previously offered under Act 20-2012, also known as the Export Services Act (“Act 20”), were, together with several other tax incentives statutes, incorporated into the Puerto Rico Incentives Code (“Incentives Code”). The Incentives Code established the new legal framework for many of Puerto Rico’s incentives programs. This Legal Update focuses on tax incentives available for export services and the export commerce industry.

Below is a quick overview of the applicable provisions related to grants of tax exemption for applications filed after December 31, 2019 by eligible businesses providing export services or engaged in export commerce activities.

I. Export Services

Section 2031.01(a) of the Incentives Code provides that any person with an office or *bona fide* establishment located in Puerto Rico for the performance of the following services in or outside of Puerto Rico, when deemed as export services, shall be eligible for a grant of tax exemption:

- a. Research and development;
- b. Advertising and public relations;
- c. Economic, environmental, technological, scientific, managerial, marketing, human resources, computer, and auditing consulting services;
- d. Advice on matters related to any trade or business;
- e. Creative industries, including the sale of tickets outside of Puerto Rico, or the sale of tickets to tourists in Puerto Rico, as well as income derived from the transfer or sale of rights for filming spectacles and productions for foreign audiences, including musical productions, eSports and Fantasy League events conducted in Puerto Rico.
- f. Production of blueprints, engineering and architectural services, and project management;
- g. Professional services, such as legal, tax, and accounting services;
- h. Centralized management services;



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- i. Centers for electronic data processing;
- j. Development of computer programs;
- k. Distribution through physical means, cyber network, cloud processing, or as part of a blockchain, and the income derived from its licensing, program subscriptions or service charges;
- l. Voice and data telecommunication between persons located outside of Puerto Rico;
- m. Call centers;
- n. Shared services centers;
- o. Educational and training services;
- p. Hospital and laboratory services including medical tourism and telemedicine facilities;
- q. Investment banking and other financial services;
- r. Marketing centers; and
- s. Any other services that the Secretary of the Department of Economic Development and Commerce, in consultation with the Secretary of Treasury, determines to be treated as an eligible service upon the understanding that such treatment is in the best interest and for the economic and social welfare of Puerto Rico.

An eligible service shall be considered for export (i.e. export service) when the service is rendered for the benefit of:

- (i) an individual who is not a resident in Puerto Rico, provided that the services do not have a nexus with Puerto Rico; or
- (ii) a trust whose beneficiaries, trustees, and grantors are not residents in Puerto Rico, provided that the services do not have a nexus with Puerto Rico; or
- (iii) an estate whose decedent, heirs, legatees, or executors are not, or, in the case of the deceased, had not been a resident of Puerto Rico, provided that the services do not have a nexus with Puerto Rico; or
- (iv) a person doing business in Puerto Rico, provided that the services do not have a nexus with Puerto Rico and that said services are destined for a client of such person who complies with any of the preceding provisions (Previously referred to as services rendered for the benefit of a foreign entity under Act 20).

The services, however, will be considered as having a nexus with Puerto Rico when they are performed in relation to Puerto Rico, including the services related to:

- 1. Business activities or for the production of income that have been or shall be conducted in Puerto Rico;

2. Advice on laws and regulations of Puerto Rico, as well as administrative procedures or pronouncements of the Government of Puerto Rico, its agencies, public corporations, instrumentalities and/or municipalities, and judicial precedents of the courts of Puerto Rico;
3. Lobbying with respect to the laws of Puerto Rico, regulations and other administrative pronouncements. For these purposes, lobbying means any direct or indirect contact with elected officials, employees or agents of the Government of Puerto Rico, its agencies, instrumentalities, public corporations or municipalities, with the purpose of attempting to influence any action or determination by the Government of Puerto Rico, its agencies, instrumentalities, public corporations or municipalities; or
4. The sale of any property for the use, consumption or disposition in Puerto Rico; and
5. Any other activity, situation or circumstance that the Secretary, in consultation with the Secretary of Treasury, designates by regulation or other ruling, administrative determination or circular letter that is related to Puerto Rico.

II. Export Commerce

Previously referred to as “trading companies” under Act 20, eligible businesses having an office or *bona fide* establishment located in Puerto Rico, which are or will be engaged in the trading or export of products, will be considered as carrying on an eligible activity for a grant of export commerce tax exemption pursuant to Section 2031.02(a) of the Incentives Code if, no less than 80% of its gross income is derived from:

- a. The sale to foreign persons, for use, consumption or disposition outside of Puerto Rico, of products bought by the eligible business for resale.
- b. Commissions derived from the sale of products for use, consumption or disposition outside of Puerto Rico.
- c. The sale of products manufactured or cultivated on demand, to foreign persons, for use, consumption or disposition outside of Puerto Rico.
- d. The sale or distribution of intangibles such as patents, trademarks, copyrights, and digital content, among others, to persons outside of Puerto Rico.
- e. The storage, transportation, and the distribution products and articles owned by third parties (also referred to as hubs).
- f. The commercial and mercantile distribution of products manufactured or cultivated in Puerto Rico for jurisdictions outside of Puerto Rico.
- g. Operations consisting om the assembly, bottling, and packaging of products for export.
- h. Any other international commercial traffic activity that may be included under the Incentives Regulations yet to be issued under the provisions of the Incentives Code.

For the above listed activities to be considered eligible as an export commerce activity, there cannot be a nexus with Puerto Rico. For this purpose, a nexus with Puerto Rico will be deemed to exist when the business is engaged in the sale of any property for use, consumption or disposition within Puerto Rico or in any other situation, activity or circumstance contemplated as nexus under the Incentives Regulations.

III. Tax Exemption Available for Export Services and Export Commerce Grants

The holder of a grant of tax exemption for export services or export commerce will benefit from the following tax incentives:

1. A 4% fixed income tax rate on its export services income (“ESI”) or export commerce income (“ECI”), respectively for the 15-year term of the grant,
2. A 100% tax exemption on distributions from earnings and profits derived from ESI or ECI,
3. Available net operating loss carry over,
4. A 75% exemption from property taxes on personal and real property used in the eligible activities, and
5. A 50% exemption from municipal taxes.

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