

September 3, 2019

## Tax Update

### *Tax Incentives for Manufacturing under the Incentives Code*

The government of Puerto Rico recently enacted Act 60-2019, adopting the Puerto Rico Incentives Code (“Incentives Code”). This sets the new legal framework for many of Puerto Rico’s incentives programs. This Legal Update focuses on manufacturing.

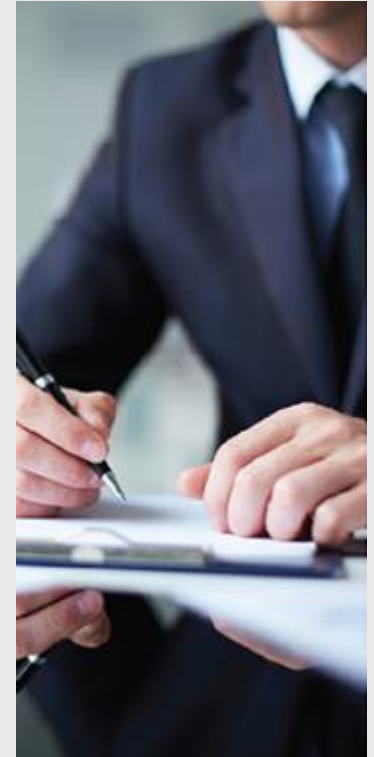
Tax exemption grants previously issued under Act 73-2008, known as the Puerto Rico Development Economic Incentives Act (“Act 73”), will now be issued under Chapter 6 of Subtitle B of the Incentives Code.

Below are some highlights of the provisions of the Incentives Code which will apply to applications filed after December 31, 2019.

### I. Eligible Activities

Pursuant to Section 2061.01 of the Incentives Code, any new or existing business can request a grant under the Incentives Code (“Manufacturing Grant”) if engaged in one of the eligible activities described below:

- An industrial unit established on a permanent basis for the production on a commercial scale of a manufactured product; which includes products transformed from raw materials, including plant or animal matter, into articles of commerce, the articles designated under previous incentives laws, and any other product, with relation to which, substantial industrial operations are realized in Puerto Rico and that in the Secretary’s judgement deserves to be considered as such due to its nature and extension, the required technology, the substantial employment it may provide, or any other benefit the operation may provide for the benefit of Puerto Rico. As with previous legislation, industrial units not eligible under this provision may qualify for export-only benefits.
- The rendering in Puerto Rico of fundamental services to business clusters or key supplier services in Puerto Rico through a bona fide office, business or establishment with its equipment and machinery with the capacity and expertise required to render a service on a commercial scale.
- Property devoted to industrial development (leasing to exempted businesses).
- The breeding of animals for scientific and medical research.
- scientific or industrial research and development for the development of new products.



For more information on this Legal Update, please contact:

**Carlos E. Serrano**  
[cserrano@reichardescalera.com](mailto:cserrano@reichardescalera.com)  
787.777.8815

**Alba I. Joubert Pereira**  
[ajoubert@reichardescalera.com](mailto:ajoubert@reichardescalera.com)  
787.777.8825

**Ernesto J. Zayas-García**  
[ezayas@reichardescalera.com](mailto:ezayas@reichardescalera.com)  
787.777.8813

- partial or total recycling activities defined under the Incentives Code.
- Planting and vertically integrated cultivation with value added processes, as well as any other agro-industrial or agricultural operation, including those operations exclusively dedicated to the packaging, crating, preservation, classification or processing of agricultural produce.
- Value added activities related to the operation of The Americas Port, the port located in the old Roosevelt Road Base, and the Mayaguez, Yabucoa, San Juan and Guayama ports and any other port designated by the Secretary of the DDEC by regulation or other official pronouncement.
- Development of licensed or patented software that may be reproduced on a commercial scale.
- Research, development, manufacturing, transportation, launching, operation from Puerto Rico of satellites and service centers for the development of data processing and storage, excluding telephone, and radio and television broadcasting operations.
- Licensing of intangible property, developed or acquired by the exempted business.
- The repair, maintenance and overhaul in general of aircraft and maritime vessels, as well as their parts and components thereof.
- The development of video games that may be reproduced on a commercial scale.

## **II. Tax Exemption for Eligible Businesses**

The income derived from the manufacturing or industrial activities of an exempt businesses holding a Manufacturing Grant, shall be subject to a 4% fixed income tax rate and the shareholders, partners, or members of the exempt business shall enjoy a 100% income tax exemption on distributions from E&P of said business.

Royalties, fees, or payments for the rights the use of intangible property in Puerto Rico, related to the eligible activities, to any foreign person not engaged in trade or business in Puerto Rico, from sources within Puerto Rico, shall be subject to a 12% income tax withholding.

As in the case of Act 73, the exempt business can alternatively enjoy a 8% fixed income tax rate and a 2% income tax withholding rate. Different than in the case of Act 73, an exempt business cannot opt to carry over lower rates enjoyed under grants issued pursuant to predecessor acts.

Minimum tax provisions continue to apply.

Municipal tax exemption under the Incentives Code is generally less than that formerly available under Act 73. Under the Incentives Code exempt tourism businesses shall enjoy:

- 50% exemption on municipal license taxes (fixing the rates in effect at the time of executing the Manufacturing Grant). The Incentives Code also introduces an option to reduce the statute of limitations for an audit by foregoing the Municipal License Tax Act's 5% discount for prompt payment.

- 75% exemption on property taxes (fixing the rates in effect at the time of executing the Manufacturing Grant)
- 75% exemption on municipal construction taxes.

Additionally, an exempt business holding a Manufacturing Grant shall enjoy:

- 100% exemption on fuels used by the exempt business to generate electric and thermal energy.
- 100% exemption of use and consumption taxes on articles to be used by the exempt business for its eligible activities.

### III. Manufacturing Tax Credits

Exempt businesses holding a Manufacturing Grant may claim the following relevant tax credits:

- A Research and development tax credit pursuant to Section 3030.01 of up to 50% for the eligible special investments made on research and development (“R&D”) in Puerto Rico. The R&D tax credit may be claimed in 2 or more installments. As a new requirement, an amount equivalent to the R&D tax credit available under the Incentives Code shall be reinvested by the exempt business in R&D activities in Puerto Rico. Further, the Incentives Code does not include specific transferability provisions for the R&D tax credit.
- A tax credit of up to 25% of the purchases made for products manufactured in Puerto Rico, including parts and accessories.
- Credit for investments in the transfer of technology – in the same amount as royalties paid for the use of intangibles for operations in Puerto Rico, usable against the exempt business’ net IDI.

The Incentives Code gives the Secretary of the DDEC ample regulatory authority to modify rules for availability and usage of tax credits.

### IV. Manufacturing Grant Applications

Eligible business may still apply for tax exemption concessions under Act 73 until December 31, 2019. However, beginning on January 1, 2020 tax exemption applications for businesses engaged in eligible manufacturing activities can only be made under Incentives Code. Manufacturing Grant applications will be handled by the new Office of Incentives for Business in Puerto Rico ascribed to the DDEC.

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