July 8, 2022

Tax Update

Act 52-2022 Provides New Alternate Income Tax Framework on Controlled Foreign Corporations Subject to the Act 154-2010 Regime

On June 30, 2022, the Governor of Puerto Rico signed House of Representatives Bill No. 1367 into Act 52-2022 ("Act 52"), known as the "Puerto Rico Public Finance Stability Act", establishing, among other things, a new alternate statutory framework for companies that have been subject to the Act No. 154-2010 ("Act 154") regime.

Although the Act 154 regime remains in place, the new statutory framework allows exempt businesses holding a tax exemption grant under the provisions of Act No. 135-1997 ("Act 135"), Act No. 73-2008 ("Act 73"), or Act No. 60-2019, also known as the Puerto Rico Incentives Code ("Incentives Code") to move into a new alternate income tax rate and tiered exemptions framework.

Below we provide an overview of the changes brought by the enactment of Act 52 on the various tax incentives laws regarding the new alternate income tax regime election. We also address items such as the expedited interagency review process for the election, changes to the tax credits framework and other amendments to the Incentives Code.

I. Alternative Income Tax Rates

Act 52 allows grantees to amend existing tax exemption grants to elect a new alternate income tax regime and extend the effectiveness of such grants for an additional 15-year term. Under this alternative, no member of a grantee's group of affiliated entities will be subject to the Act 154 regime and, instead, the grantee shall then be subject to a 10.5% income tax rate on its industrial development income ("IDI").

In the event that Sections 11(b), 250(a)(3), 951A or any other provision of the Internal Revenue Code is amended to effectively impose a 15% income tax rate, grantees having made the election will then be subject to an income tax rate of 15% on their IDI.

If such an election is made, the grantee may then also be subject to a tiered tax exemption framework on IDI which varies depending on levels of employment and income as follows:

1. 20% exemption on IDI of every exempt business with an average employment of 1,000 or more direct employees, and that also generated IDI of $300,000,000 or more during the immediately preceding taxable year. However, in the case that the exempt business is subject to the 15% tax rate, the average employment requirement is lowered to 100 direct employees.

For more information on this Legal Update, please contact:

Carlos E. Serrano
cserrano@reichardescalera.com
787.777.8815
787.406.5257

Alba I. Joubert Pereira
ajoubert@reichardescalera.com
787.777.8825
787.432.8356

Ernesto J. Zayas García
ezayas@reichardescalera.com
787.777.8813
787.354.4757

2. 67% exemption on IDI of every exempt business, with an average employment of 1,000 or more direct employees, and that also generated IDI of $2,500,000,000 or more during the immediately preceding taxable year.

3. 75% exemption on IDI of every exempt business, with an average employment of 1,000 or more direct employees, and that also generated IDI of $7,500,000,000 for the immediately preceding taxable year.

4. 85% exemption from the payment of income taxes for the IDI of every exempt business, with an average employment of 4,000 or more direct employees, and which payments for the use of intangibles subject to income tax were equal to, or greater than, 90% of their IDI for the immediately preceding taxable year.

The withholding tax established under the alternate tax framework for payments made by the exempt business to corporations, partnerships or nonresidents, not engaged in trade or business in Puerto Rico, for the use, or right to use patents, copyrights, formulas, technical know-how and other similar property in Puerto Rico in connection with its exempt operations now varies from 10%, 12% and 13% tax rate depending on certain income requirements, job creation, and the tier to which the exempt business qualifies for.

The estimated income tax payment provisions for businesses subject to the Act 154 regime have also been amended to provide those grantees which elected the alternative tax framework shall no longer be required to make estimated tax payments as ordinary. Instead, they shall be required to make the corresponding estimated tax payment on or before the 15th day of the month following the commencement of the transition period and then each month thereafter until the last the day of the eleventh month of said period.

II. Interagency Evaluation for Applications to Elect the New Alternate Income Tax Framework

A new section is added to Act 135, Act 73 and the Incentives Code to establish a new and expedited interagency evaluation process for grantees that elect the alternative tiered tax framework established under Act 52.

Once the application for amendment to a grant electing the alternate tax framework is filed with the Office of Incentives for Businesses in Puerto Rico (“OI”), its Director shall notify the Secretary of the Department of Treasury (“Treasury”) a copy of the application within 5 days from its date of filing. The Secretary of Treasury shall then verify the compliance of the exempt business with its tax liability in Puerto Rico. Noncompliance with the tax liability of non-resident shareholders, subject to certain exceptions, will be basis for the Secretary of Treasury to not endorse the request for election to this new regime.

The OI shall issue an eligibility report and a recommendation regarding the amendment to the grant and shall notify a draft of amendment to the grant to Treasury for evaluation and recommendation. Any unfavorable recommendation must include justified reasons and Treasury shall have 10 days to submit a report or recommendation to the draft of amendment to the grant.

If Treasury favorably recommends the application or, if Treasury does not issue a recommendation within the established 10-day period, it shall be understood that the amendment has been favorably endorsed. Once endorsed, the Secretary of Economic Development and Commerce will then proceed with a final determination.

III. Changes to Tax Credits Framework

Act 52 also amends the tax credits provisions under Act 73 to establish that the tax **credit for investment in transfer of technology** provided in Section 5(f) shall not be available to grantees electing the new alternative income tax rate.

For tax years commencing after December 31, 2021, the **research and development ("R&D") tax credits** afforded under Section 5(c) of Act 73 shall now be subject to several additional requirements and limitations.

1. The filing of the report on R&D activities to request a certification of special eligible investments shall now be accompanied by an Agreed Upon Procedures report prepared by a certified public accountant licensed in Puerto Rico.

2. The R&D tax credit for tax years beginning after December 31, 2021, shall be claimed in two or more installments; up to 50% of which may be claimed in the year when the accreditive certificate is issued and the balance on subsequent years, subject to the carryover limitations set forth in amendments to the 2011 Code.

Additionally, the minimum tax payment ("MTP") limitation imposed by Section 5(h) on the use of tax credits afforded pursuant to Act 73 now provides that the MTP cannot be less than the amount of tentative tax computed under Section 3 or 3A of Act 73.

A new Section 1051.16 is added to the 2011 Code authorizing the creation of a new **Tax Credits Management System** ("MCC", for its Spanish acronym) within Treasury. Tax credits shall now be categorized as Pre-MCC or Post-MCC depending on whether such tax credit has been issued prior to, or after, the implementation of the MCC, the exact date of which shall be published by Treasury through a general communication.

1. Pre-MCC tax credits have to be claimed, sold or transferred, and used, within 3 years after the implementation date of the MCC.

2. Post-MCC tax credits must be registered at the MCC to be claimed.

Furthermore, Act 52 amends Section 2106(b)(7) of the 1994 Code to establish a tax credit for members of a controlled group that contribute to the Puerto Rico Science, Technology, and Research Trust Fund. These credits, as established in Section 2106(b), provide for credits that can be available, under regulation, for a person subject to the excise tax under Section 2101 of the 1994 Code.

III. New Provisions under the Incentives Code

A new **Compliance Professional** figure is created under the Incentives Code and a new **Compliance Certification** must be filed annually by exempt businesses attesting to their compliance with commitments under the grant.

Grantees' **Bill of Rights** under the Incentives Code has been amended to provide that the binding contract nature of the grants between the Government of Puerto Rico and grantees shall be subject to grantees' procurement of a **Certificate of Compliance** validating its compliance with the terms and conditions of its grant.

As new prerequisite for applications of grants of tax exemption for tourism and industrial activities under the Incentives Code, the grantee must show a financial commitment with Puerto Rico by way of depositing 10% of its exempt income at financial institutions located in Puerto Rico.

Lastly, Act 52 provides a sunset for applications for grants of tax exemption under the Qualified Physician provisions of the Incentives Code. Applications for qualified physicians tax exemptions will no longer be accepted after June 30, 2022.

***
