



## SUMMARY OF TAX BENEFITS UNDER PUERTO RICO ACT 22 AND ACT 20

By: Ricardo Muñiz

### ACT 22

The Act to Promote the Transfer of Investors to Puerto Rico, Act Number 22 of January 17, 2012 (“**Act 22**”), combined with US Internal Revenue Code (“**US-IRC**”) provisions dealing with Puerto Rico (“**PR**”) and its residents, provide extraordinary income tax benefits to an individual that:

- (i) did not reside in PR at any time from January 16, 2006 through January 16, 2012;
- (ii) becomes a resident of PR after January 17, 2012; and
- (iii) obtain a Tax Exemption Grant under Act 22 from the PR Office of Industrial Tax Exemption (“**OITE**”).<sup>1</sup>

The above described individual (“**Eligible Individual**”) must be certain that he qualifies as “Bona Fide PR Resident”, as defined in US-IRC §937. Otherwise, he will be fully subject to US income taxes on his worldwide income.<sup>2</sup> All references herein to PR resident or PR residency refers solely to a Bona Fide PR Resident.<sup>3</sup>

Generally, Act 22 provides the following PR income tax benefits, most of which can be matched with the US-IRC income tax exemption that is only available to Bona Fide PR Residents.

1. PR income tax exemption on dividends and interest from all sources. The US-IRC generally provides US income tax exemption on PR source dividends and interest earned by a “Bona Fide PR Resident”. However, dividend and interest income from Non PR sources (i.e., US or foreign sources) will be subject to US income taxation.

2. Capital gains (long and short term) derived from the appreciation of securities after commencement of PR residency are exempt from PR income taxation. These gains will not be subject to US income taxation if the securities were not owned prior to becoming a PR resident, and if so owned, when sold after 10 years of PR residency, as these are considered PR source income under the US-IRC.



That portion of capital gains attributable to the appreciation in value of securities owned by such individual at the time he becomes a PR resident, and which are sold within the 10 years following commencement of PR residency, will not be considered PR source income under the US-IRC, and are not entitled to US income tax exemption.<sup>4</sup> On the other hand, that portion of the capital gains attributable to the appreciation in value of such securities following the Eligible Individual's commencement of PR residency will be considered PR source income under the US-IRC, and will be exempt from US income taxation. These portions of the capital gains are calculated differently depending on whether the securities are marketable or not<sup>5</sup>.

3. That portion of capital gains derived from the sale or exchange of securities owned before the Eligible Individual became a PR resident, that are realized after 10 years of PR residency and are attributable to the appreciation in value before such Eligible Individual's commencement of PR residency, will be subject to a reduced 5% PR long term capital gains tax rate. This 5% PR tax applies even though there will be no US income tax on these gains (i.e., as these gains are considered PR source income under the US-IRC, and gains derived from the appreciation of securities purchased prior to PR residency that are sold by a PR resident after 10 years of PR residency are exempt from US income tax).

The foregoing benefits of Act 22 are conditioned on the Bona Fide PR Resident acquiring a residential property in PR, and opening a deposit account (personal or business) in a bank or cooperative operating in PR<sup>6</sup>. Eligible Individuals have two (2) years from the date they notify their residency in PR to the OITE to submit evidence to the OITE of the acquisition of such residential property.

Individuals that request the benefits of Act 22 with the OITE are subject to a \$750 filing fee that is payable upon filing the grant's petition, and a \$5,000 fee upon the issuance of the Tax Grant. Eligible Individuals must yearly file an annual report with the OITE, no later than April 15 of the following year, reflecting their compliance with the terms and conditions of the grant during such year, together with an annual fee of \$300.

Eligible Individuals should consider the PR forced heirship rules,<sup>7</sup> and those estate planning strategies that can be utilized to reduce the effects of such rules prior to moving to PR. The objective of such planning would be reducing their estate's potential US estate tax exposure. Once these individuals become PR residents the options of reducing such exposure are more limited.

## Act 20

Act 20 of January 17, 2012 (“**Act 20**”) provides PR tax exemption to entities that render “eligible export services” from PR to clients outside PR.<sup>8</sup> These services include, but are not limited to, advisory services on matters relating to any trade or business; investment banking and other financial services; advertising and public relations; economic, environmental, technological, scientific, management, marketing, human resources, information and audit consulting services; professional services (such as medical, legal, tax and accounting services); development of computer programs and research and development.

A business that renders eligible export services can request the issuance of a Tax Exemption Grant under Act 20. Pursuant to such Grant the export services business will only be subject to a 4% fixed PR income tax rate on its net income, and 100% PR income tax exemption on dividends. In addition, such business should not be subject to US income taxes to the extent the services are rendered in PR. Act 20 Grantees are also entitled to 90% real and personal PR property tax exemption, and 60% exemption from the PR municipal gross receipts tax.

**Furthermore, a Bona Fide PR Resident that is a shareholder of a corporation organized under the laws of PR that becomes an Act 20 Grantee will not be subject to US or PR income tax on dividends paid by such corporation if the dividends are deemed PR source income under the US-IRC. Moreover, if the entity that enjoys the Act 20 tax Grant is a pass-through or disregarded entity under the US-IRC, the individual Bona Fide PR Resident will generally only be subject to the 4% income tax rate that PR imposes on the Act 20 entity’s PR source business income, without such individual being generally subject to US income tax, or any other PR income tax, on such income.**

In order to obtain a tax grant under Act 20, the eligible export services business must commit to having a minimum of five (5) full-time employees in PR that are engaged in such business. During the first five months after commencing operations Act 20 grantees will not be required to have any direct full-time employees in Puerto Rico. By the sixth month, and for the next eighteen months, Act 20 grantees must have at least three (3) direct full-time employees. For the remaining term of the Act 20 tax exemption grant, Act 20 grantees must employ at least five (5) direct full-time employees.

Eligible export services businesses that request the benefits of Act 20 with the OITE are subject to a \$750 filing fee that is payable upon filing the petition for the grant. Once the Act 20 grant is issued, grantee must yearly file an annual report with the OITE, no later than April 15 of the following year, reflecting its compliance with the terms and conditions of the grant during such year, together with an annual fee of \$300.



**It should be noted that Act 22 and 20 present unique and extraordinary tax benefits that are only available for Bona Fide PR Residents, and that nowhere else in the world will US citizens and residents receive similar tax benefits.**

*Adsuar Muñiz Goyco Seda & Pérez-Ochoa, P.S.C. (“AMG”) can advise and assist you in obtaining the previously described tax benefits of Act 22 and Act 20, particularly the technical issues related to qualifying as a Bona Fide PR Resident under the US-IRC and its regulations, the US-IRC source of income rules and US tax implications of these Acts, and requesting the respective tax grants under such Acts. AMG can also assist with all your other legal needs in PR, including but not limited to, real estate transactions, labor and employment law issues, and your personal estate planning.*

<sup>1</sup> These tax benefits remain in effect for as long as such individual maintains his PR residency, and up to the year 2035.

<sup>2</sup> Even though all other US citizens and US residents are subject to US income tax on their worldwide income, those that are Bona Fide PR Residents are exempt from US income taxation on their PR source income, other than amounts received for services performed as an employee of the US or any agency thereof, pursuant to US-IRC §933.

<sup>3</sup> See AMG Puerto Rico Business Law Notes, Article 2016-03, dated May 31, 2016, on the US-IRC regulatory requirements to qualify as a Bona Fide PR Resident.

<sup>4</sup> US-IRC Regulations §1.937-2(f)(1).

<sup>5</sup> The term marketable securities is defined US-IRC Regulations §1.937-2(f)(1)(vi).

<sup>6</sup> This residential property acquisition requirement applies to applications for the benefits of Act 22 filed after November 30, 2015 pursuant to Act Number 187 of November 17, 2015.

<sup>7</sup> Generally, when the decedent has descendants, two thirds of the estate must go to descendants.

<sup>8</sup> Act Number 232 of December 19, 2014.

The above summary is intended for information purposes only. It cannot be considered a legal opinion, and it does not intend to consider all the tax and legal considerations that could be relevant to any particular person or entity.

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Ricardo Muñiz  
787-281-1818  
[muniz@amgprlaw.com](mailto:muniz@amgprlaw.com)

Caridad Muñiz-Padilla  
787-281-1817  
[cmuniz@amgprlaw.com](mailto:cmuniz@amgprlaw.com)

César R. Rosario  
787-281-1820  
[rosario@amgprlaw.com](mailto:rosario@amgprlaw.com)

Miguel Carbonell  
787-281-1968  
[mcarbonell@amgprlaw.com](mailto:mcarbonell@amgprlaw.com)