

## International Tax Puerto Rico Highlights 2017



### Investment basics:

**Currency** – US dollar (USD)

**Foreign exchange control** – No

**Accounting principles/financial statements** – US GAAP. Financial statements generally are required annually, along with supplemental financial information.

**Principal business entities** – These are the corporation, limited liability company, partnership, joint venture, cooperative, closely held corporation and branch of a foreign company.

Entities operating in Puerto Rico (PR) generally need to register with the PR State Department, the Puerto Rico Treasury Department, the State Insurance Fund, the PR Labor Department and any municipality where a fixed place of business is established.

### Corporate taxation:

**Residence** – A company is resident in Puerto Rico if it is created or organized in Puerto Rico (i.e. a domestic corporation) or is a foreign corporation engaged in a trade or business in Puerto Rico.

**Basis** – Domestic corporations are taxed on their worldwide income. Nonresident corporations are taxed on their Puerto Rico-source income and income that is effectively connected with a Puerto Rico trade or business. For tax purposes, the US is considered a foreign jurisdiction.

**Taxable income** – Corporate tax is imposed on a company's net income, which consists of all income (less certain exclusions), reduced by ordinary and necessary business expenses. A portion of the expenses paid to a related party may be subject to disallowance.

**Taxation of dividends** – Dividends paid to shareholders generally are taxed at a rate of 20%.

**Capital gains** – Capital gains are taxed at a rate of 20%.

**Losses** – Net operating losses (NOLs) incurred in tax years beginning after 31 December 2004 and before 1 January 2013 may be carried forward for 12 years; NOLs incurred in tax years beginning after 31 December 2012 may be carried forward for 10 years. The NOL deduction is limited to 80% of the net income for the year. Losses may not be carried back.

**Rate** – The corporate tax rate in Puerto Rico comprises a base rate of 20%, plus a graduated surcharge.

**Surtax** – A graduated surcharge is levied in addition to the corporate income tax, at rates that range from 5% to 19%. The maximum surcharge rate is reached at levels exceeding USD 275,000 of net income. The first USD 25,000 of net income is not subject to the surcharge. If a corporation is under common control, a surcharge exclusion may be granted to one entity or may be allocated among the controlled group equally or according to an apportionment plan agreed upon by all members of the controlled group.

**Alternative minimum tax** – The alternative minimum tax (AMT) is calculated as the "alternative minimum net income" taxed at a 30% rate, reduced by the alternative minimum credit for foreign taxes paid.

**Foreign tax credit** – Resident corporations and partnerships may credit taxes paid to foreign governments, as well as to the US and other US possessions, against the corresponding Puerto Rico tax.

**Participation exemption** – No

**Holding company regime** – No

**Incentives** – Various incentives are available, such as tax rate reductions for manufacturing services and export services, which can lower the income tax rate to 4% or less.

### Withholding tax:

**Dividends** – Dividends paid to foreign corporations generally are subject to a 10% withholding tax. Special rules apply to distributions from partnerships.

**Interest** – Interest paid to related parties not engaged in a trade or business in Puerto Rico generally is subject to a 29% withholding tax.

**Royalties** – Royalties paid to nonresidents are subject to a 29% withholding tax.

**Technical service fees** – A special contribution of 1.5% of the total contract amount is imposed on any contract for professional services, consulting services or legal services entered into with the Commonwealth of Puerto Rico.

**Branch remittance tax** – A resident foreign corporation that derives less than 80% of its income from Puerto Rico activities is subject to branch profits tax at a rate of 10%, in lieu of the 10% withholding tax on dividends. This is an annual determination made at the time the tax return is filed, and the tax could be due even when an actual dividend has not been paid.

**Other** – Other items of fixed or determinable annual or periodic Puerto Rico-source income that are paid to nonresident aliens or foreign corporations and US citizens are subject to a 29% and a 20% withholding tax, respectively. Income subject to the withholding tax includes royalties, license agreements and rental payments.

### Other taxes on corporations:

**Capital duty** – No

**Payroll tax** – Payroll tax consists of social security contributions and unemployment (federal and state) and disability insurance. Puerto Rico employers are subject to the "FICA" and "FUTA" provisions of the US Internal Revenue Code.

**Real property tax** – The tax rate varies by location, but most municipalities assess a tax of approximately 8.03% to 11.83% of the 1958 market value of the property.

**Social security** – Social security taxes are comprised of old age/survivor/disability taxes (OASDI) and Medicare/hospitalization insurance, both borne equally by the employer and the employee as a percentage of the employee's wages, with the employer responsible for remitting the tax to the federal government. The combined OASDI rate is 12.4% (i.e. 6.2% each for the employer and the employee) and the combined Medicare rate is 2.9% (i.e. 1.45% each for the employer and the employee). OASDI is levied on the first USD 127,200 of wages for 2017. Medicare is levied on total wages. The

portion of social security taxes borne by the employer is tax deductible.

**Stamp duty** – See under "Transfer tax."

**Transfer tax** – The transfer of real property is subject to a stamp tax. The transfer tax to be paid depends on the value of the property transferred.

**Other** – Personal property tax is imposed on certain personal property located in Puerto Rico (e.g. average monthly inventory, furniture and fixtures and supplies). The rates range from 5.80% to 9.83%.

A municipal license tax is imposed on the gross receipts of a business. The rate imposed depends on the municipality (generally, the rate is 0.5%).

### Anti-avoidance rules:

**Transfer pricing** – Puerto Rico's transfer pricing regulations are similar to those in the US. The Puerto Rico Treasury Department is currently working on issuing local regulations.

**Thin capitalization** – While there are no specific thin capitalization rules in Puerto Rico, guidance is provided based on the US rules.

**Controlled foreign companies** – No

**Disclosure requirements** – No

### Compliance for corporations:

**Tax year** – Taxpayers may elect to use a fiscal year or the calendar tax year.

**Consolidated returns** – Consolidated returns are not an option under the tax code. Each entity must file a separate return.

**Filing requirements** – All resident corporations are required to file a tax return by the 15th day of the fourth month after the close of the previous tax year. Resident partnerships are required to file a tax return by the 15th day of the third month after the close of the previous year. Extensions for three months may be requested.

**Penalties** – Monetary penalties may be imposed at rates up to 25%, and a 10% surcharge also is applied. Civil and criminal penalties apply in certain cases for failure to comply with the tax law.

**Rulings** – Private rulings are available from the Puerto Rico Treasury Department for pending transactions. Closing agreements and voluntary disclosure agreements also may be negotiated with the tax authorities.

### Personal taxation:

**Basis** – Residents of Puerto Rico are taxed on their worldwide income, regardless of their citizenship, while nonresidents are subject to tax on their Puerto Rico-

source income. Nonresident individuals are taxed on gross income effectively connected with a trade or business in Puerto Rico.

**Residence** – An individual is resident if he/she is domiciled in Puerto Rico. For tax purposes, there is a presumption that an individual who is present in Puerto Rico for a period of 180 days or more in a calendar (tax) year is a resident. The facts and circumstances are critical in determining residence status.

**Filing status** – Depending on a taxpayer's civil status and personal circumstances, he/she may file as an individual taxpayer, a married taxpayer or a married taxpayer filing separately from his/her spouse.

**Taxable income** – Individuals must include all forms of remuneration, less qualified exclusions, in taxable income. Adjustments may be made for deductions, personal exemptions and credits for dependents.

**Capital gains** – Capital gains are taxed at a rate of 20%.

**Deductions and allowances** – Residents of Puerto Rico are entitled to itemize certain allowable deductions.

**Rates** – Progressive rates are imposed up to 33%. An additional surtax of 5% is imposed on the tax liability determined if the net taxable income exceeds USD 500,000.

#### Other taxes on individuals:

**Capital duty** – No

**Stamp duty** – The transfer of real property is subject to a stamp tax. The transfer tax to be paid depends on the value of the property transferred.

**Capital acquisitions tax** – No

**Real property tax** – The tax rate varies by location, but most municipalities assess a tax of approximately 8.03% to 11.83% of the 1958 market value of the property.

**Inheritance/estate tax** – No estate tax generally is levied where the property is located in Puerto Rico and the deceased was born in Puerto Rico. Individual taxpayers born outside Puerto Rico are subject to a specific tax regime under which a portion of their estate may be subject to tax.

**Net wealth/net worth tax** – No

**Social security** – Social security taxes are comprised of old age/survivor/disability taxes (OASDI) and

Medicare/hospitalization insurance, both borne equally by the employer and the employee as a percentage of the employee's wages, with the employer responsible for remitting the tax to the federal government. The combined OASDI rate is 12.4% (i.e. 6.2% each for the employer and the employee) and the combined Medicare rate is 2.9% (i.e. 1.45% each for the employer and the employee). OASDI is levied on the first USD 127,200 of wages for 2017. Medicare is levied on total wages. The portion of social security taxes borne by the employer is tax deductible.

#### Compliance for individuals:

**Tax year** – Calendar year

**Filing and payment** – Taxpayers are required to file their taxes by 15 April following the close of the previous tax year. An extension to file may be requested.

**Penalties** – Penalties may be imposed at rates of up to 25%, in addition to a 10% surcharge. Other civil and criminal penalties also may apply.

#### Sales and use tax:

**Taxable transactions** – Puerto Rico levies a sales and use tax on taxable goods and services.

**Rates** – The standard rate is 11.5%. Services rendered to other merchants (B2B) and designated professional services are taxed at a 4% rate.

**Registration** – A taxpayer that sells or uses taxable items must register as a merchant with the Puerto Rico Treasury Department.

**Filing and payment** – Sales and use tax returns must be filed on a monthly basis.

**Source of tax law:** Internal Revenue Code for a New Puerto Rico (2011), as amended

**Tax treaties:** Puerto Rico does not have any tax treaties, nor is it a party to any agreement signed by the US.

**Tax authorities:** Puerto Rico Treasury Department

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