
Puerto Rico Tax Incentives: The TCJA and other considerations

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Section I

INTERNATIONAL TAX PROVISIONS

International Tax Provisions

Corporate Tax Rates and Other Provisions

- Corporate tax rate is 21%.
- A Controlled Foreign Corporation (CFC) is a foreign corporation if **more than 50%** of the total combined voting power or value of the stock of such corporation is owned or considered as owned by United States shareholders.
- A United States shareholder is a **US person** who owns or is considered as owning **10% or more** (by vote or value) of a any foreign corporation.

International Tax Provisions

Corporate Tax Rates and Other Provisions, cont.

- IRC §957(C): a shareholder who is a bona fide resident of Puerto Rico is not a US person in relation to an entity taxed as a corporation organized in Puerto Rico if a dividend received by such shareholder is treated as income derived from sources within Puerto Rico under IRC §933
- Therefore, a Puerto Rico corporation is **not** a CFC when it is 50% or more owned by Puerto Rico resident (shareholders). If excluded from the CFC regime, no deemed repatriation of income to US resident shareholders applies.

International Tax Provisions

Global Intangible Low Tax Income (GILTI)

- This provision applies to Controlled Foreign Corporations.
- GILTI is computed as the excess of:
 - the shareholder's prorata share of the CFC's net income (after foreign taxes), over
 - the shareholder's prorata share of the CFC's deemed tangible income return (which is basically a return equal to 10% over the corporation's tax basis in tangible property).
- In the case of a service business, tangible property can be very limited or none.
- No GILTI application if the corporation is not a CFC.

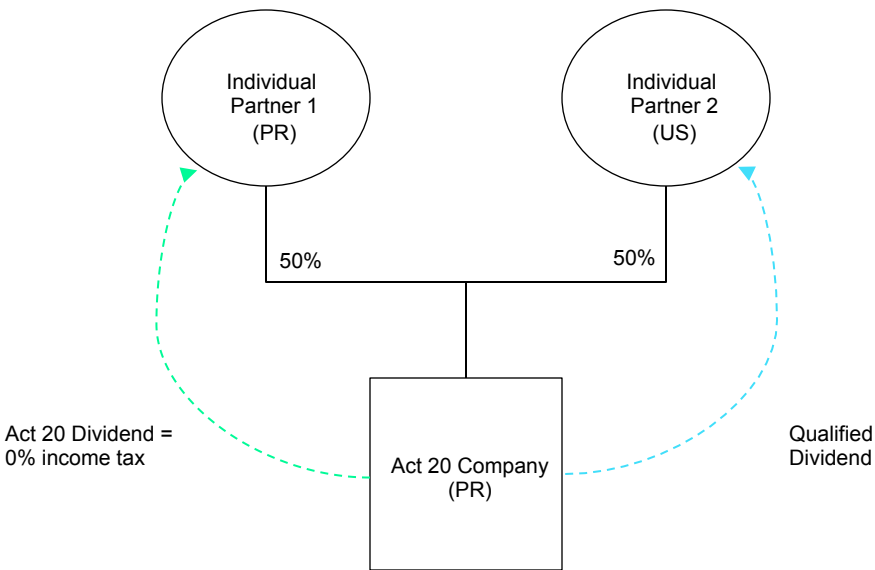
International Tax Provisions

Global Intangible Low Tax Income (GILTI)

- With certain deductions, the effective tax rate for corporate shareholders is 10.5% up to December 31, 2025 and 13.125% for taxable years commenced after December 31, 2025.
- Starting on January 1, 2018, United States shareholder individuals of a CFC will be subject to ordinary income tax rates on the GILTI.
- Foreign tax credits available upon foreign income tax paid with respect to GILTI, but limited to an 80%, without carry back or carry forward.
- A US Shareholder may have §962 election- election to be taxed at corporate rates on certain gross income (related to CFCs).

International Tax Provisions

Example: Post-TCJA + GILTI Effect + 957(c)



- An active Act 20 Company has 2 partners, a PR partner (50%) and a US partner (50%)
- The Company pays its 4% income tax rate on the active service income
- Upon distributions from the Act 20 Company:
 - PR partner receives its distributions from the Act 20 Company at a 0% income tax rate
 - US partner has a qualified dividend on the distribution

Legend



Individual



Entity taxed as a corporation for US and Puerto Rico income tax purposes

Section II:

INDIVIDUAL TAXPAYERS

Individual Taxpayers

Income Tax Rates

- Personal Income Tax rates reduction after TCJA:
 - The highest income tax rate applicable to individuals was reduced from 39.6% to 37%.
 - Previously, the income tax rates had 6 tax rates: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%;
 - Current Income Tax Rates : 10%, 12%, 22%, 24%, 32%, 35%, and 37%.

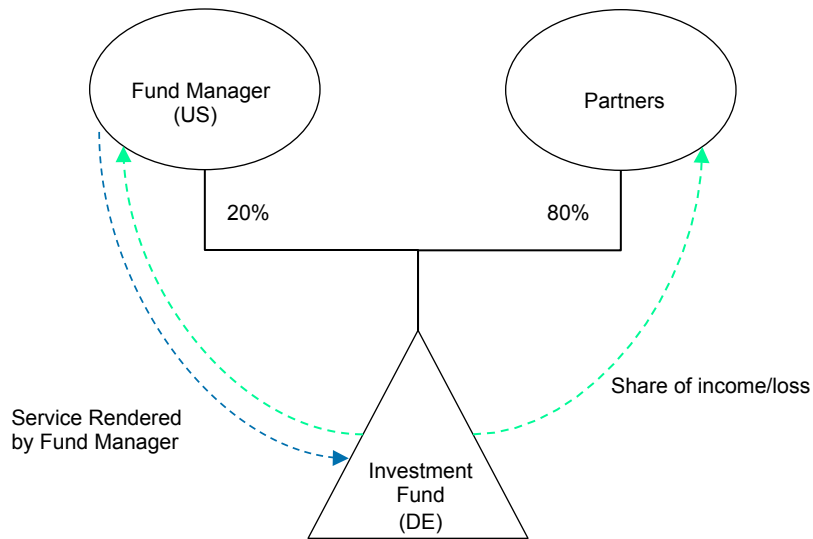
Individual Taxpayers

Carried Interest for Services

- A profits interest in a partnership is any interest other than a capital interest.
- A profits interest gives the holder the **right to receive future profits and appreciation in value of assets of a partnership**, but doesn't give the holder a share of the proceeds upon the immediate liquidation of the partnership.
- The receipt of a capital interest for services provided by a partnership results in taxable compensation for the recipient. However, under a safe harbor rule, the receipt of a profits interest in exchange for services provided is **not a taxable event** to the recipient if the profits interest entitles the holder to share only in gains and profits generated after the date of issuance.

Individual Taxpayers

Example: Hedge Funds- Pre-TCJA



- Fund Managers are compensated for the services rendered to the fund by means of a profit interest.
- The receipt of the profit interest by the Fund Manager is not a taxable event to the Fund Manager.
- The Fund and the Manager treat the Manager as having a partnership interest.
- Accordingly, Fund Manager accounts for his or her distributive share of the Fund's income or loss for income tax purposes.
- Long-term capital gain treatment to Fund Manager through its profits interest when the Funds sells capital assets held for more than one year.

Legend



Individuals or any other type of taxpayer

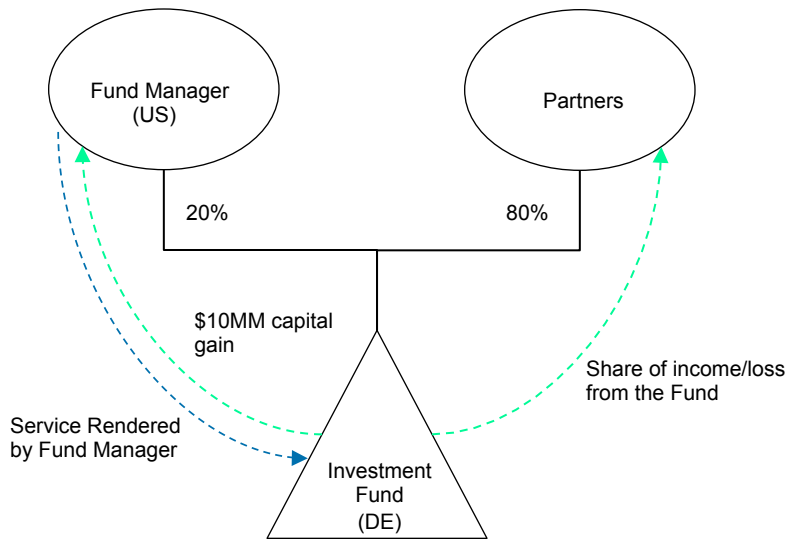


Entity taxed as a partnership for PR and US tax purposes

Individual Taxpayers

Example: Hedge Funds- Pre-TCJA, cont.

- A Fund raised capital of \$100MM and sold its investments held over a year for \$150MM, resulting in a \$50MM gain.
- The Manager had 20% carried interest, therefore his or her distributive share of the gain is \$10MM.
- The gain is taxed at a 20% long term capital gain rate, plus 3.8% net investment income tax.
- The Manager generated a net after tax return of \$7.62MM.



Legend



Individuals or any other type of taxpayer



Entity taxed as a partnership for PR and US tax purposes

Individual Taxpayers

Carried Interest for Services, cont.

- In general, the Act imposes a 3-year holding period requirement on the sale of partnership assets which affects taxpayers holding **applicable partnership interests** received as managers and/or sponsors with respect to income allocations intended to be treated as long-term capital gains in relation to the sale of **specified assets**.
- In the case the time threshold has not been met, the income would be considered short term capital gain and taxed at ordinary income tax rates.
- Fund may use borrowing mechanism to get capital interest instead of carried interest.
- Flow-through gain/bifurcation issue.

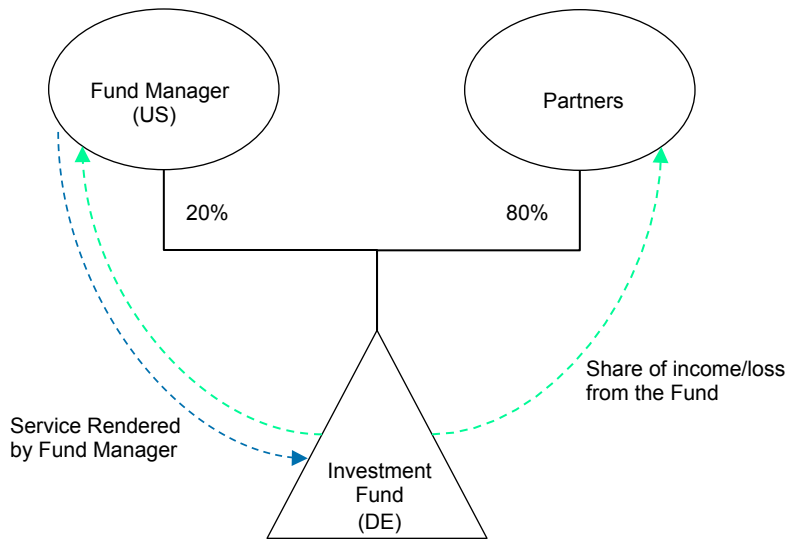
Individual Taxpayers

Carried Interest for Services, cont.

- Applicable partnership interests: interest in a partnership held by or transferred to the taxpayer related to the performance of [his or her] substantial services in any applicable trade or business.
- An applicable trade or business is a regular activity consisting of:
 - Raising or returning capital; and
 - Either investing in or disposing of specified assets or developing *specified assets*

Individual Taxpayers

Example: Hedge Funds-Post-TCJA, cont.



- If the Fund sells capital assets before holding the same for 3 years, any realized gain allocated to the managers holding the profit interest will be taxed at ordinary income tax rates. (The US Scenario)
- If the Fund Manager were to **restructure** its compensation as a basic fee plus a contingent fee based on certain metrics and (i) the services were rendered from Puerto Rico, (ii) using a Puerto Rico entity not engaged in business in the United States, and (iii) managers were residing in Puerto Rico, through Act 20, the net income from services would only suffer a 4% PR income tax (no federal income tax). There would be no impact on the tax treatment of the service income regardless of the holding period of the underlying assets of the partnership being sold. (The PR Scenario)

Legend



Individuals or any other type of taxpayer



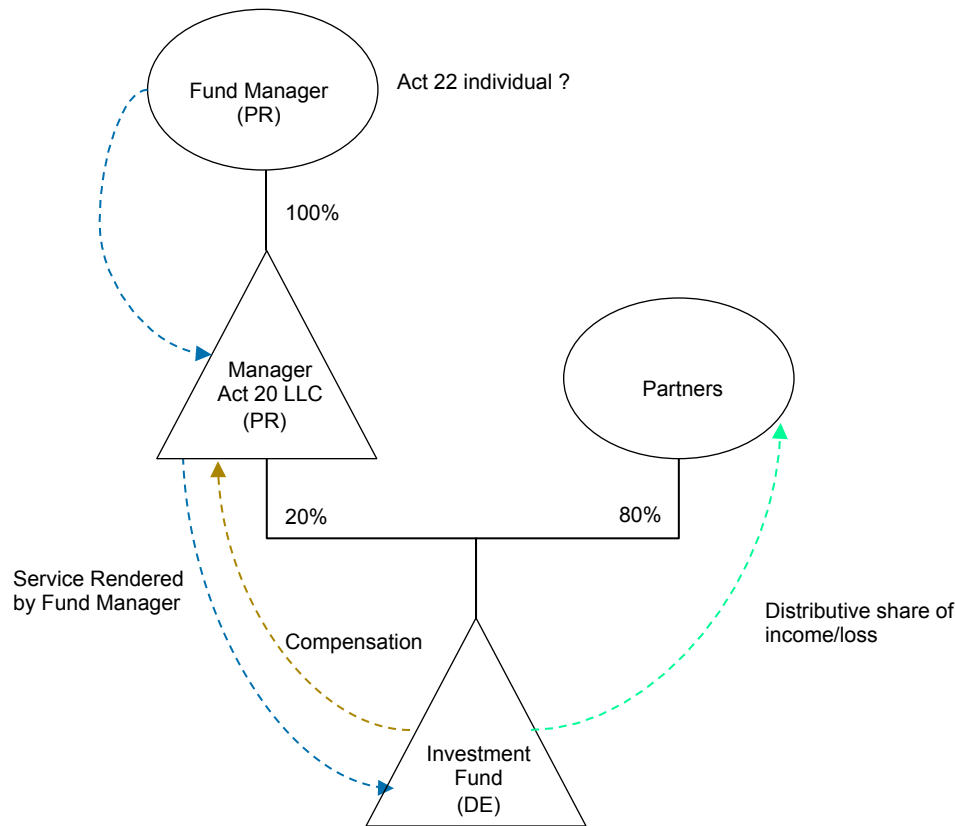
Entity taxed as a partnership for PR and US tax purposes

Individual Taxpayers

Post-TCJA: Additional Thoughts?

Within the PR Scenario- additional thoughts:

- Structure servicing Opportunity Zone (OZ) funds with no PR nexus or under the Act 20 decree, as a promoter (Promoter decree).
- PR OZ funds & IRC §933 together with an Act 22 ?
- US Tainted assets subject to bifurcation, after 10 years (of being a bona fide resident of PR) US taint disappears and then it can be disposed with no US tax provided person is a bona fide resident of PR at the time of disposition. This is the reverse OZ, i.e., for accrued gains rather than realized gains seeking deferral.



Legend

○ Individuals or any other type of taxpayer

△ Entity taxed as a partnership for PR and US tax purposes

Section III:

OUR TEAM

Our Team

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- Mr. Ríos-Méndez leads PMA's tax practice. He primarily focuses on international tax matters, inbound and outbound corporate reorganizations, registered investment companies, structured investment vehicles and other complex federal, international and Puerto Rico tax law matters. Mr. Ríos-Méndez has been active in some of the major Puerto Rico tourism related projects with respect to the negotiation of tax incentive grants and the sale of tourism investment tax credits.
- In the Puerto Rico industrial tax incentive area, Mr. Ríos-Méndez has assisted clients in the industrial and service sectors and in recent times has actively participated in the negotiation of tax incentives for clients in the financial services industry. He has requested private letter rulings and negotiated closing agreements with the Puerto Rico Treasury Department for the Firm's clients. Mr. Ríos-Méndez has acted as tax counsel in the structuring of financing transactions with borrowers located in Puerto Rico, the Baltic region, Eastern Europe and Asia.

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- If you have any questions or comments, or wish additional information regarding this presentation, please contact:

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