

Doing Business in Puerto Rico

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Organization

Investors have a variety of options for optimizing liability shield and tax treatment characteristics in Puerto Rico. Partnerships do not necessarily receive pass-through tax treatment and not all corporations necessarily face double taxation. Instead, both partnerships and corporations face taxation both at the partnership/corporate and partner/shareholder levels as the default rule, but both have the option of electing pass-through tax treatment if they meet certain criteria.

In Puerto Rico, partnerships may be organized under the Civil Code, the Commercial Code, or the Limited Liability Partnership Act. Generally, partnerships have some common characteristics. The civil code treats a partnership as a juridical entity separate from the partners. Except for partners in limited liability partnerships and limited partners of limited partnerships and special partnerships, the liability of the individual partners is unlimited and joint with respect to losses, damages, disbursements and obligations.

Puerto Rico's General Corporations Law is based on Delaware's. Puerto Rico corporations must maintain a designated principal office and agent in Puerto Rico for

service of process. Nonresidents of Puerto Rico and non-U.S. citizens may own stock and serve as directors and officers of a Puerto Rico corporation. Where permitted by the law of a foreign corporation's state of incorporation, Puerto Rico law allows for merger with a non-Puerto Rico corporation.

All corporations that are not organized under Puerto Rico laws are considered foreign corporations. Prior to conducting business in Puerto Rico, foreign corporations must register with the Puerto Rico Department of State, which will usually permit a foreign corporation to do business in Puerto Rico as long as the proposed business is permitted and no other corporation is doing business under the same name. Legal process against a foreign corporation may be served on its authorized resident agent, who must be either a natural or judicial person residing in Puerto Rico, but cannot be a stockholder, officer, or director of the corporation.

Limited Liability Companies may engage in any lawful activity but must maintain a registered office and resident agent for service of process in Puerto Rico. The management of an LLC is typically governed by an LLC





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agreement. LLCs are generally taxed at both the business entity and member levels, but can file for pass-through tax treatment.

Basic Requirements & Procedures for Starting a Business

Entities engaged in business in Puerto Rico must fulfill the following requirements or registrations before starting operations:

- A. Obtain a federal Employer Identification Number from the U.S. Internal Revenue Service.
- B. Register with the Registry of Businesses at the Puerto Rico Treasury Department.
- C. Register with the Compulsory Business Registry.
- D. Provide written notice to each municipality in which it has commenced operations and request a provisional license for the quarter in which it commences operations.
- E. Register with the Bidders Registry if pursuing business with any government agency.
- F. A license from the Puerto Rico Treasury Department may be required to carry out certain activities or to sell certain products.
- G. A construction permit from the Regulations and Permits Administration (ARPE) if seeking to construct a new structure or modify an existing one.
- H. A Use Permit from ARPE when the construction for which the construction permit was issued is completed. For the use permit to be issued, the business will need to have the Sanitary License from the Department of Health when required and the Fire Department Inspection.
- I. Construction and Use Permits are also acquired, where the operation will be located in an Autonomous Municipality from the Municipality's Permit Office.
- J. A construction and operation permit from the Environmental Quality Board for the operation of an emergency power plant. An emergency plan for the prevention of diesel spills may also be required.
- K. Municipalities have the power to impose and collect construction taxes within its territorial limits. The construction tax rate is generally around 4% or 5% of the cost of the project. There are various exemptions from the construction tax for nonprofit associations and affordable housing projects, among others.

Other reporting requirements and taxes may apply after commencement of operations.

Business, Manufacturing and Services

Puerto Rico provides attractive tax and other incentives to “eligible businesses” to foster investment in key sectors. Eligible businesses include businesses established to: manufacture products; render services for foreign markets or for other eligible businesses in Puerto Rico; engage in certain activities such as scientific research and development, generation of renewable power, recycling, hydroponics, software development, manufacture of renewable energy equipment, among others.

Approved eligible businesses qualify for the following benefits, among others: reduced income tax rates, exemption on real and personal property tax, tax credits, reduced tax rate on royalties or license fees, exemption from municipal license tax, exemption from excise tax and sales and use tax. In addition, various special incentives have been created to encourage the establishment and retention of local and foreign investment.

The Puerto Rico Science, Technology and Research Trust provides a financing option for research, development, and infrastructure projects in the fields of science and technology.

The Puerto Rico Human Resources and Occupational Development Council offers workforce training incentives.

Labor and Employment Law

Both federal and local labor and employment laws apply in Puerto Rico.

Unless otherwise agreed, there is a presumption that employer-employee relationships are for an indefinite period, but employers are permitted to hire employees for specific time periods or based on other defined conditions; such contracts should be in writing.

Payroll taxes, including applicable income, social security, local and federal unemployment, and disability taxes, are subject to withholding. In addition, all employers must obtain workmen compensation insurance from the State Insurance Fund. This insurance provides compensation to employees for work-related accidents or conditions. If the employer hires non-executive employees who are required or permitted to operate motor vehicles,



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Chauffeur's Insurance must be paid instead of the Puerto Rico Disability Benefits Tax.

The federal minimum wage applies to businesses operating in Puerto Rico that have annual gross volume of sales of at least \$500,000. The Puerto Rico minimum wage applies to businesses excluded from the federal minimum wage and is the equivalent to seventy percent (70%) of the prevailing federal minimum wage.

Employees not covered by the Fair Labor Standards Act are covered by Puerto Rico's wage-and-hour laws and are entitled to double pay for work in excess of regular time. Special rules apply to employees working on Sundays and certain holidays. Under Puerto Rico law, the word "employee" does not include executives, administrators, professionals, or labor union officials or organizers when acting as such.

Hourly employees are entitled to paid vacation and sick leave, generally of 1.25 days and one day per month, respectively. The employee has to work at least one hundred and fifteen (115) hours a month in order to receive such benefits.

Employers are required to pay a bonus calculated as provided by law during the period from December 1 to December 15 of each year to each employee who works at least 700 hours during the 12-month period commencing October 1 of each calendar year. Certain exemptions may be available.

Female employees are generally entitled to an eight-week maternity leave with full pay (including for adoption when the adopted child is 5 years of age or less). The employer is required by law to reserve the position. Upon return to work, time is allotted during each full-time working day for breastfeeding.

An employee hired for an indefinite term who is discharged without just cause is entitled to severance pay as provided by law. Employees hired for a probationary period are not covered, provided their contract is in writing and the probationary period does not exceed 3 months.

Real Estate

Investors interested in obtaining property either to develop or to operate a business should understand the basics of Puerto Rico real estate.

The Registry of Property is an archive that contains all recorded documents pertaining to the ownership and other rights over real property. The recordation of a property's history in the Registry is a safeguard for those interested in acquiring any rights over a property. Anyone interested in purchasing a property should first obtain a title study stating the status of such property's recordation in the Registry. This information will provide the purchaser with any liens and encumbrances the property may have. Except in certain exceptional cases, anyone who purchases a property pursuant to the Registry will be protected from third parties alleging rights encumbering the property.

The sale of real property must be evidenced by a public deed executed before a notary public and recorded in the Property Registry.

Any person or entity can lease real estate in Puerto Rico via a private contract. The civil code states that any lease agreement may be terminated if the title holder sells the leased property unless the parties have executed a long-term lease via a public deed or the parties have mutually agreed, pursuant to a public deed, that the lease may be recorded in the Property Registry.

Zoning

The Puerto Rico Planning Board (PRPB) uses zoning to establish the parameters, guidelines, and rules on how and where specific social and economic activities will be permitted. Puerto Rico has zoning maps that show the various zoning districts around the island.

Anyone seeking to develop a real estate project should request a site consultation from the PRPB. The PRPB is authorized to consider changes to the zoning of any given sector or piece of land to accommodate new uses.

Autonomous Municipalities have and manage their own land use plan. In these municipalities, zoning changes must be run through the municipal government pursuant to its own rules and procedures.

Permits

Permits are required to construct buildings and establish businesses in Puerto Rico. These permits can be obtained from the Regulations and Permits Administration (ARPE). Autonomous Municipalities are authorized to handle permitting for projects within their territory. They issue the



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same permits as ARPE, but they utilize their own forms and procedures. Some of the most common permits are: environmental assessment, use permit; installation of signs or advertisements; and demolition permit.

Foreign Trade Zones

Puerto Rico has the largest noncontiguous Foreign Trade Zone (FTZ) system in the United States. The system allows companies to obtain significant financial savings, since raw material, components, and packaging can be transported tax-free throughout these zones and items shipped abroad after processing are exempt from U.S. taxes. Puerto Rico offers importers the option of operating under FTZ procedures within all of its municipalities.

The benefits of operating within a FTZ include: paying duties either at the rate applicable to the foreign material in its condition as admitted into a zone, or if used in manufacturing or processing, at the emerging product rate); allowing deferment of the corresponding duty while in the zone); and FTZ operators can also obtain certain tax advantages in Puerto Rico.

Environmental Laws

As a territory of the United States, Puerto Rico is subject to both federal and local environmental laws and regulations. The Environmental Protection Agency (EPA) has delegated certain responsibilities for managing and enforcing federal environmental programs to the Puerto Rico Environmental Quality Board (EQB). With respect to those programs for which there has been no delegation in many cases EPA and EQB have agreements to coordinate the enforcement and implementation of their regulations. The EQB has issued regulations establishing standards designed to minimize environmental harm and control activities that cause pollution. The EQB enforces these regulations with fines for each violation and by suspending, amending or revoking any permit, approval or other authorization.

The Puerto Rico Department of Natural and Environmental Resources is charged with creating programs for the use and conservation of the natural resources of Puerto Rico based on the standards established by the EQB. Other agencies are charged with regulating specific environmental issues, such as hazardous materials transport, land use planning, and construction.

Puerto Rico's Environmental Public Policy Act typically requires an endorsement letter from a "lead governmental agency" to the EQB and is required as a precondition to obtaining other permits.