



A new framework for development and attracting capital to Puerto Rico

Act No. 22 of 2012 to Promote the Relocation of Individual Investors

Act 22
of 2012

- **Objective:** To attract new residents to Puerto Rico by providing a total exemption from Puerto Rico income taxes on all passive income realized or accrued after such individuals become bona fide residents of Puerto Rico
- **Goal:** New local investments in real estate, services and other consumption products, and capital injections to the Puerto Rico banking sector, all of which will accelerate the economy of Puerto Rico
- **Duration:** The incentives will expire on December 31, 2035



Incentives under Act 22

No taxes on passive income for New Residents of Puerto Rico until 2036

100% Tax Exemption on Dividends and Interest

- New Residents will enjoy a **100% tax exemption** from Puerto Rico income taxes on all dividend and interest income.
- Interest and dividends that qualify as Puerto Rico source income will not be subject to federal income taxation under Section 933 of the IRS Tax Code. New Resident investors may be able to reduce the tax rate applied on interest and dividend income coming from sources outside of Puerto Rico (including the source country taxation) to 0% or 10%, respectively, by investing through certain Puerto Rico investment vehicles.

100% Tax Exemption on Short- and Long-Term Capital Gains

- New Capital Gains: All capital gains accrued after becoming a New Resident will be **100% exempt** from Puerto Rico taxes. **These gains will not be subject to federal taxes.**
- Prior Unrealized Capital Gains: All capital gains accrued and unrealized prior to becoming a New Resident will be subject to a tax of (i) 10%, if such gain is recognized within 10 years of new residence in P.R., and (ii) 5%, if such gain is recognized after said 10-year period. Such taxes paid may be used as a credit in another jurisdiction that taxes such gains. The U.S. will not tax any prior unrealized gains if recognized after 10 years of residence in Puerto Rico.
- To qualify for the Act 22 incentives, all gains must be recognized prior to January 1, 2036.



Requirements for the Incentives

New Residents that had not lived in Puerto Rico for the last 15 years

New Bona Fide Resident

- A Puerto Rico resident is an individual who is domiciled in Puerto Rico. Physical presence in Puerto Rico for a period of 183 days during the taxable year will create a presumption of residence in Puerto Rico for tax purposes.
- Section 937 of the U.S. Internal Revenue Service Code provides additional guidance as to what is generally considered a bona fide resident: (a) no tax home outside Puerto Rico during the tax year, and (b) no closer connection to the U.S. or a foreign country.
 - The information contained in this section should not be construed as legal/tax advice. Questions regarding the residency matters discussed in this section should be addressed with your legal or tax counsel.

Non-Resident for Last 15 Years

- The New Resident must not have been a resident of Puerto Rico at any time during the 15-year period preceding the effective date of Act 22, which period would be from January 16, 1997 through January 16, 2012.



Tax Exemption Decree

Providing certainty for our new residents

- **Tax Exemption Decree:** To enjoy the benefits granted under the Individual Investors Act the new resident must apply for and obtain a tax exemption decree under the Act, which will be signed by the Secretary of the Department of Economic Development and Commerce of Puerto Rico.
- **Certainty until 2036:** The Tax Exemption Decree will constitute a contract with the Puerto Rico Government not subject to subsequent legislative changes. It guarantees the incentives till 2036.
- **Application:** Interested persons may obtain a Tax Incentive Application from the Office of Industrial Tax Exemption, which is available on their website <http://www.oeci.pr.gov>. Applicants who submit a complete application should expect to have their Decree in approximately 5 business days.



Lower Tax Rates than in the U.S.

Compare tax rates for dividends and interest

Average U.S. Resident

- Average State Dividend Tax Rate: 6%
- Federal Qualified Dividend Tax Rate: 15%¹
- Average State Interest Tax Rate: 7%
- Federal Interest Tax Rate: 35%



Potential Increase in Rates with the Upcoming Expiration of Bush Tax Cuts

New Puerto Rico Resident

- Puerto Rico Dividend Tax Rate: 0%
- Federal Dividend Tax Rate: 0%²
- Puerto Rico Interest Tax Rate: 0%
- Federal Interest Tax Rate: 0%²



Zero taxes in Puerto Rico until 2036

¹ This preferential rate is set to increase to 39.6% after December 31, 2012 with the expiration of the Bush Tax Cuts.

² Puerto Rico residents do not pay federal taxes on Puerto Rico source income. With respect to dividend and interest income from sources outside Puerto Rico, New Puerto Rico Residents may reduce the federal tax rate applicable to 0% and 10%, respectively, when investing through certain Puerto Rico investment vehicles.



Lower Tax Rates than in the U.S.

Compare the tax rates for capital gains

Average U.S. Resident

- Avg. State Short-Term Cap Gains Tax Rate: 7%
- Federal Short-Term Cap Gains Tax Rate: 35%

- Avg. State Long-Term Cap Gains Tax Rate: 5%
- Federal Long-Term Cap Gains Tax Rate: 15%¹



Potential Increase in Rates with the Upcoming Expiration of Bush Tax Cuts

New Puerto Rico Resident

- Puerto Rico Short-Term Cap Gains Tax Rate: 0%
- Federal Short-Term Cap Gains Tax Rate: 0%

- Puerto Rico Long-Term Cap Gains Tax Rate: 0%
- Federal Long-Term Cap Gains Tax Rate: 0%



Zero taxes in Puerto Rico until 2036

¹ This preferential rate is set to increase to 20% after December 31, 2012 with the expiration of the Bush Tax Cuts.



Savings Example

100% tax exemption on all dividend and interest income

- **Assumptions:** John Smith has a portfolio with a market value of \$1MM with an average annual return of \$50,000 in interest and \$50,000 in dividends.
- **See the Savings**

John in the U.S.	
• Annual Dividend Income:	\$50,000
• Annual Interest Income:	<u>\$50,000</u>
• Total Dividend and Interest Income:	\$100,000
• State and Federal Dividend Taxes:	\$10,500
• State and Federal Interest Taxes:	<u>\$21,000</u>
• Total Taxes:	\$31,500
• Net Income After Taxes:	\$68,500

John in Puerto Rico	
• Annual Dividend Income:	\$50,000
• Annual Interest Income:	<u>\$50,000</u>
• Annual Dividend and Interest Income:	\$100,000
• State and Federal Dividend Taxes:	\$0 ¹
• State and Federal Interest Taxes:	<u>\$0¹</u>
• Total Taxes:	\$0
• Net Income After Taxes:	\$100,000

Total Annual Savings: \$31,500 or 31.5%

¹ Puerto Rico residents pay no federal income taxes on Puerto Rico source income. With respect to dividend and interest income from sources outside Puerto Rico, New Puerto Rico Residents may reduce the federal tax rate applicable to 0% and 10%, respectively, when investing through certain Puerto Rico investment vehicles.



Savings on Capital Gains

100% tax exemption on capital gains

- Assumptions:** John Smith has a portfolio with a market value of \$1MM with an unrealized capital gain of \$500,000. It appreciates \$100,000 annually.

John in the U.S.

TODAY

• Today's Portfolio Market Value:	\$1,000,000
• Portfolio's Tax Basis:	\$500,000
• Portfolio's Unrealized Capital Gains:	\$500,000

SALE IN 6 YEARS

• Portfolio Market Value:	\$1,600,000
• Old Capital Gain:	\$500,000
• New Capital Gain:	\$600,000
• Taxes on Old Capital Gain:	\$100,000
• Taxes on New Capital Gain:	\$120,000
• Total Taxes:	\$220,000

SALE IN 11 YEARS

• Portfolio Market Value:	\$2,100,000
• Old Capital Gain:	\$500,000
• New Capital Gain:	\$1,100,000
• Taxes on Old Capital Gain:	\$100,000
• Taxes on New Capital Gain:	\$220,000
• Total Taxes:	\$320,000

John in Puerto Rico

TODAY

• Today's Portfolio Market Value:	\$1,000,000
• Portfolio's Tax Basis:	\$500,000
• Non-PR Unrealized Capital Gains:	\$500,000

SALE IN 6 YEARS

• Portfolio Market Value:	\$1,600,000
• Non-PR Capital Gain:	\$500,000
• New PR Capital Gain:	\$600,000
• Taxes on Non-PR Capital Gain:	\$100,000
• Taxes on New Capital Gain:	\$0
• Total Taxes:	\$100,000

SALE IN 11 YEARS¹

• Portfolio Market Value:	\$2,100,000
• Non-PR Capital Gain:	\$500,000
• New PR Capital Gain:	\$1,100,000
• Taxes on Non-PR Capital Gain:	\$25,000 ¹
• Taxes on New Capital Gain:	\$0
• Total Taxes:	\$25,000

¹ The U.S. will not tax any prior unrealized capital gains if recognized after 10 years of residence in Puerto Rico. Puerto Rico will tax such gain at 5%.